Modification Report
URGENT Modification Reference Number 0357
Amendment to System Entry Overrun Charge in respect of Entry Capacity Entitlements based on a Seasonal Normal Demand Profile

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 Ofgas has agreed that this Modification Proposal should be treated as Urgent because it amends certain rules contained in the revised Entry Capacity Entitlements regime which take effect from 1 October 1999.

The modification proposal seeks to set a maximum cap on the level of system entry overrun charges, which will allow shippers to price bids on the OCM at a level which ensures that, if they do not hold adequate System Entry Capacity, they will not suffer financial loss as a result of an unpredictable overrun. If left unchanged, the potential during any gas flow day for overrun charges to increase as SAP increases could lead to uncertainty among shippers when pricing bids. This may deter shippers from making gas available on the OCM in circumstances where they have insufficient usable System Entry Capacity

Given that shipper willingness to participate in the market is viewed as a factor in assessing the robustness of the revised regime and that the provisions of Modification 0314 will be implemented on 1st October 1999 it is essential that this proposal is treated as urgent.

2.Procedures Followed:

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

Issued to Ofgas for decision on urgency7 September 1999
Proposal agreed as Urgent7 September 1999
Proposal issued for consultation8 September 1999
Close out for Representations9 September 1999
Report to Ofgas10 September 1999

3.The Modification Proposal:

It is proposed that a “lesser of test” be included within B 2.10.3(iv) such that the overrun will be the lesser of:

1.5 times SAP for the gas day or;

the highest SAP in the 18 months preceding D-1.

4.**<u>Transco's opinion:</u>**

Transco supports the modification proposal since it amends the rules setting out the determination of the system entry overrun charge which, in their present form, may dissuade shippers bidding on the OCM The modification proposals seeks to remove the uncertainty in the level of financial exposure that shippers bidding on the OCM could face, thus encouraging shipper participation on the OCM in circumstances where a shipper may not have sufficient usable System Entry Capacity to support the bid, but where the System would benefit from such a bid.

5. **<u>Extent to which the proposed modification would better facilitate the relevant objectives:</u>**

The proposal should encourage shipper participation on the OCM, which should improve its liquidity thus furthering the requirements of:

Condition 7 (1)(a) - "*the efficient and economic operation by the licensee of its pipe-line system*

6. **<u>The implications for Transco of implementing the Modification Proposal , including:</u>**

a)**<u>implications for the operation of the System:</u>**

In some circumstances the operation of the System may benefit from the delivery of gas through an accepted OCM bid when the bidding user does not have sufficient System Entry Capacity. This proposal enables a shipper to more accurately price such a bid to allow for a subsequent overrun charge and should encourage market participation in such circumstances. Increased participation may improve liquidity and lead to more efficient System balancing.

b)**<u>development and capital cost and operating cost implications:</u>**

This proposal is an amendment to modification 0314 for which systems developments have been implemented. The proposed new rule can be operated within the current systems specification and no capital or operating costs are anticipated.

c) **<u>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:</u>**

N/A

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

N/A

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:

There will be no increase in the level of contractual risk to Transco.

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

No new computer systems will be introduced in order to implement this modification.

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

The proposal, if implemented will provide a cap on the level of potential overrun charges. In addition, that maximum level will be a known quantity as it is based on a series of historical SAP results. This will allow users to place bids when they do not have sufficient System Entry Capacity with greater cost certainty.

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:

Implementation of the proposal may be of benefit to the independent market operator in that a potential barrier to shippers trading on the OCM will be removed.

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;

The maximum level of overrun to be used in B 2.10.3 (iv) will be known before the gas day
Increased predictability of overrun charge
Retains market sensitivity
Proposal can be implemented quickly
Minimal systems change requirements

Disadvantages;

The proposed cap is related to prices over the previous eighteen months as opposed to the day in question.

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

Transco has received comments from twelve respondents on the modification proposal.

Of these respondents, seven supported the Modification proposal, four respondents did not support it and one expressed no overriding view.

Summary of issues raised in response to the proposal;

General:

A number of respondents supported the principle but suggested alternative methods of achieving the aims.

One respondent (Dynergy) does not agree that a multiple of SAP should have any place in the consideration of overruns for daily entry capacity. In their opinion using SAP is a backward step for development of the network code and will result in gas being held "off the market". Another respondent also agrees that the proposal will not increase the likelihood of gas brought to market.

Average SAP:
A number of respondents suggested that an average SAP would be an appropriate measure to be incorporated in the proposal. One respondent (EPETL) suggested a thirty day rolling average and another (ENRON) suggested an eighteen month average. Both respondents indicated that the benefit of their suggestions are that price spikes will be avoided in the overrun calculation. One of the respondents (EPETL) also noted that a peak cost may be disregarded on the day that it occurs but will subsequently be eligible for consideration in the succeeding eighteen month period.

Fixed overrun:
One respondent (BGT) proposed that the test should be that all overrun provisions within B 2.10.3 are capped at a fixed price. This can be achieved by amending the lesser of rule to reflect the fixed price provision. Another respondent (Amerada) also suggested a simpler fixed rate overrun charge for consideration, though in their response they have suggested that the rule should only apply when overruns occur at constrained terminals.

Disregard clause 2.10.3 (iv):
On respondent (National Power) suggested that there should be no link to energy balancing in the overrun calculations and to that end the simplest solution is to delete clause 2.10.3 (iv)

Inflated costs:
A number of respondents (Nat Power, EPETL, BP Gas, Enron & BGS) are concerned that the proposal, if implemented may lead to escalating gas prices. This situation

could develop if shippers offer gas at the previous highest SAP to cover entry, plus the intrinsic value of the gas.

Mixed signals:
One respondent (Aquila) highlighted that it is not ideal to mix signals from the old (Flex) and new (OCM) regimes.

Transco Response:

General:
Transco are pleased with the level of support and the constructive comments regarding this proposal. However, it does appear that there has been some confusion regarding the purpose of the modification proposal. The proposal has not been introduced to facilitate a general reduction in overrun charges although a reduction will be affective in circumstances where the cap applies. Its primary aim is to deliver predictability for shippers so that they may better understand their risks associated with participation in the OCM without sufficient System Entry Capacity. Transco remains of the view that the use of SAP as an overrun parameter is a necessary tool to mitigate any risk of shippers delivering gas, in the absence of System Entry Capacity to take account of high cash out prices. This is essential to preserve the rights of firm capacity holders when constraints could occur.

Average SAP:
The introduction of rolling averages for SAP, whether for thirty day or eighteen month periods introduces a more onerous systems development requirement than that implied by a straightforward test for maximum recorded readings. Transco does not believe that it could introduce the more complex rolling average concept in time for an October delivery.

Additionally the use of average price signals will serve as the proposers intend to take out price spikes from consideration of overrun charges. This will increase the number of occasions when the cap will apply and it may be profitable to flow gas without purchasing the matching capacity rights. On all such days the link between the overrun and the gas price on the day will breakdown.

Fixed overrun:
Transco recognize that the proposal can be simplified for shippers if this part of the overrun is subject to a fixed price cap. Such a pragmatic solution would build upon the aims of the proposal to provide shippers with greater certainty of prices that they may face, Whilst making the cap more transparent. In the light of this suggestion Transco will amend its final proposal so that the lesser of rule shall be with regard to the a maximum overrun charge of 0.6054 p/kWh. This price is the highest SAP over the previous eighteen months, having occurred on 6 December 1998.

Disregard clause 2.10.3 (iv):
Transco believe that if all links to SAP are removed from the overrun calculation then there will be an increased probability that shippers will deliver gas in the absence of sufficient capacity to take advantage of high cash out prices.

Inflated costs:

It is expected that the OCM will be a liquid market. The implication of this is that sufficient quantities of gas will be available such that any extreme prices that are posted will only rarely be accepted.

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

This proposal is not required to facilitate compliance with safety or other legislation.

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:

This modification is not proposed as a result of changes to the methodology established under Standard Condition 3(5).

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

The functionality to incorporate this proposal into the existing systems already exists. A Programme of works is not required.

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

Transco recommends that this proposal is implemented with effect from 1st October 1999 at the same time as the implementation of Modification 0314

18.Recommendation concerning implementation of the Modification Proposal:

Transco recommends that this Modification Proposal is implemented. The proposal will modify the provision of Network Code Modification 0314, in particular B 2.10.3 (iv)

19.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.

20.Transco's Proposal:

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Director General in accordance with this report. The proposal has been amended in response to shipper comments and now includes within B 2.10.3 (iv) the proposal that the overrun will be the lesser of:

1.5 times SAP for the gas day or;

0.6054 p/kWh

21.<u>Text:</u>

Delete text in paragraph B2.10.3 (iv) and insert;

“(iv) the lesser of:

(a) (1.5 x D) where ‘D’ is the System Average Price for that day; or

(b) E, where ‘E’ is 0.6054 p/kWh”

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

<u>Director General of Gas Supply Response</u>:

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 **0357**, version **1.0** dated **10/09/1999**) be made as a modification to the Network Code.

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

Signature:

Director of Trading Arrangements

Date:

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.