

**DISCUSSION DOCUMENT ON PROPOSED SOLUTIONS FOR THE TREATMENT
OF MARCH 1996 ENERGY BALANCING QUANTITIES.**

Introduction

A meeting was held on 4 April 1996 to review the March Operations of the Network Code. Concerns were expressed regarding the prices derived from the first month's use of the flexibility mechanism and their use in calculating balancing and reconciliation charges. At this meeting TransCo was requested to draft a paper looking at these issues.

The 2 agreed options to be considered were:

- (1) To change the end of month cash-out price and the daily reconciliation prices to the same price. TransCo was asked to compare three price scenarios and their impacts on the neutrality calculations.
- (2) To incorporate imbalance quantities with an estimate of reconciliation quantities in the pre-code run-off arrangements, Transition Document Part IV.

This paper therefore discusses the two proposals in detail and makes a recommendation on the way forward.

Option 1

Option 1 is to change the end of month imbalance cash-out price and daily reconciliation prices to the same price. This option is considered with 3 separate pricing scenarios.

This proposal builds upon the outstanding Modification Proposal 13.

The following examples show the difference in charges between a shipper who followed TransCo's forecasts when planning their portfolio's balance (Example 1) versus a shipper who used their own forecasting data to balance (Example 2).

Example 1: Shipper who followed NDM nominations / allocations.

NDM allocation	100
Inputs	<u>100</u>
EoM Cash-out	0
Deemed Output	100
Actual Output	<u>80</u>
Reconciliation	+20 @ daily SAP (Sale by Shipper).

Example 2 Shipper who followed own view of balance.

NDM allocation	100
Inputs	<u>80</u> @ EoM SAP
EoM Cash-out	-20 (Purchase by Shipper)

Deemed Output	100
Actual Output	<u>80</u> @ daily SAP
Reconciliation	+20 (Sale by Shipper).

It was therefore agreed, at the meeting, that in order to have a neutral effect between imbalances and reconciliation, all the daily SAP's and the end of month SAP should be the same.

It was acknowledged that it was not desirable to retrospectively change market prices. However, the implementation issues agreed previously makes March a special case for consideration.

3 price scenarios for the months SAP were asked to be considered:

- | | | |
|-------|-----------------------------|--------------|
| (i) | the Network Code 30 day SAP | 0.6701 p/kWh |
| (ii) | the modification 13 price | 0.5000 p/kWh |
| (iii) | the Heren Index for March | 0.3412 p/kWh |

Each case is considered:

- If the drafting clarification for Balancing Margins and Top-Up Modification proposal 14 is approved , and
- If the aforementioned proposal 14 is not approved.

The results are shown in Appendix A and are summarised below:

Case	Drafting Mod 14	Price Basis	Price p/kWh	March Cap £m
1(a)	Not Agreed	SAP	0.6701	15.34
1(b)	Not Agreed	Mod 13	0.5000	14.73
1(c)	Not Agreed	Heren	0.3288	14.12
2(a)	Agreed	SAP	0.6701	11.90
2(b)	Agreed	Mod 13	0.5000	11.45
2(c)	Agreed	Heren	0.3288	10.99

Note: The calculation of the cap values is based on data prior to March allocation close-out. In addition all system prices could be changed to the same price. This acknowledges difficulties in Shipper understanding of their cumulative balance position and the high level of unauthorised flow.

Benefits

- (i) Uses a "neutral" price for March agreed by the Industry.
- (ii) Maintains the treatment of energy quantities under the Network Code.
- (iii) Uses existing systems functionality and thereby has a recognisable audit trail.
- (iv) No additional smearing of systems costs.

Issues

Requires the re-running of March reconciliations to alter the prices, not the quantities.

In assessing different price options this raises additionally the following issues:

- i) Is the Heren index any more arbitrary than SAP? It could be argued that the SAP does reflect more closely the costs of balancing intervention during March.
- ii) There is a concern that the spot market was not liquid during March and therefore prices would not be reflective of a value for gas.
- iii) A Heren index generated price and SAP are opposite ends of the scale. Shippers who have bought high priced spot gas, in order to achieve a balance, may feel penalised by a lower cash out price, eg. based on the Heren index.
- iv) Does intervening send the wrong signals to the market for the future? Will the flex mechanism send the right signals to correct over or under deliveries in April, if shippers think prices may change? Why is the 19p/th SAP not a neutral price for reconciliation, especially considering there may be swings and roundabouts during March that would net out?

Option 1a

Taking account of the above pricing issues, an alternative approach to option 1 would be to change the reconciliation prices to a neutral price and leave all other prices as generated by the flexibility mechanism. The benefit of this approach would be that the prices for imbalances represent the value of balancing gas in the month.

Option 2

Option 2 considers the calculated imbalance quantities and a forecast of reconciliation quantities and the inclusion of such quantities in the run-off Arrangements, Transition Document Part IV, for pre-code imbalances.

The calculation of the imbalance quantity would be calculated in the normal way. However, the calculation of an appropriate reconciliation quantity is extremely speculative as it requires a prediction of each shipper's reconciliation variance for March. In addition the month end cash-out has no direct connection with the reconciliation process.

A close-out position for March could be determined, giving an opening read for April. However, this is effectively what the system does by deeming values and therefore represents the "best view".

It is therefore concluded this option could potentially only achieve a degree of practicality if;

(i) the imbalance quantities were netted off against the run-off quantities,

and

(ii) a "neutral" price used for the March reconciliations.

Benefits

(i) Imbalances are cashed out at individual shipper prices and not system generated prices.

Issues

(i) Establishing satisfactory predictions of reconciliation quantities.

(ii) A new and ongoing mechanism would be required to avoid double counting March reconciliation quantities.

(iii) The existing pre-code run-off arrangements are counter balanced. March imbalances are a net over delivery to the system, and therefore would cause balancing actions or imbalances to counter the quantities during the run-off arrangements. (The net imbalance quantity for March is 268 GWh).

(iv) There is a major systems impact in separating reconciliation quantities from the invoicing process.

Given the timing available and the issues above, this is not a viable option for implementation.

Recommendations

TransCo recommends the adoption of option 1 as the only appropriate methodology for clearing March imbalances and reconciliation in a reflective and timely manner.

APPENDIX A

SUMMARY OF MARCH BALANCING CAP CALCULATIONS

Case 1a) No OM BM mod, price = 30 day SAP			
	Quantity GWH	Price p/kWh	£m
Net flex buy/sell at market prices	-356		12.95
OM and BM noms at SAP	88	0.6701	0.59
End of month imbalance	-268	0.6701	1.80
Basic neutrality Charges			15.34

Case 1b) No OM BM mod, price = mod 0013 = 0.5000 p/kWh			
	Quantity GWH	Price p/kWh	£m
Net flex buy/sell at market prices	-356		12.95
OM and BM noms at SAP	88	0.5000	0.44
End of month imbalance	-268	0.5000	1.34
Basic neutrality Charges			14.73

Case 1c) No OM BM mod, price = Heren = 9.6349 p/th = 0.3288 p/kWh			
	Quantity GWH	Price p/kWh	£m
Net flex buy/sell at market prices	-356		12.95
OM and BM noms at SAP	88	0.3412	0.30
End of month imbalance	-268	0.3412	0.91
Basic neutrality Charges			14.16

Case 2a) No OM BM mod, price = 30 day SAP			
	Quantity GWH	Price p/kWh	£m
Net flex buy/sell at market prices	-356		12.95
BM rebate for flex bids accepted	-71	4.5868	-3.27
OM and BM noms at SAP	88	0.6701	0.59
OM and BM noms at rebate	88	0.1833	-0.16
End of month imbalance	-268	0.6701	1.80
Basic neutrality Charges			11.90

Case 2b) No OM BM mod, price = mod 0013 = 0.5000 p/kWh			
	Quantity GWH	Price p/kWh	£m
Net flex buy/sell at market prices	-356		12.95
BM rebate for flex bids accepted	-71	4.5868	-3.27
OM and BM noms at SAP	88	0.5000	0.44
OM and BM noms at rebate	88	0.0132	-0.01
End of month imbalance	-268	0.5000	1.34
Basic neutrality Charges			11.45

Case 2c) No OM BM mod, price = Heren = 9.6349 p/th = 0.3288 p/kWh			
	Quantity GWH	Price p/kWh	£m
Net flex buy/sell at market prices	-356		12.95
BM rebate for flex bids accepted	-71	4.5868	-3.27
OM and BM noms at SAP	88	0.3412	0.30
OM and BM noms at rebate	0	-0.1456	0.13
End of month imbalance	-268	0.3412	0.91
Basic neutrality Charges			11.02