Draft Modification Report
Modification Reference Number 0361
Compensation for end dating of firm St Fergus entry capacity rights

This draft Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal:

The proposer considers that :

“The new capacity regime results in Transco appropriating at no value users' previously booked entry capacity to the extent that their annual booking extends beyond 1 October 1999. This appropriation of rights is required so that the new auction regime acts as a clean break from the previous system.

At the time of the St Fergus constraints, shippers had various options open to them where they had insufficient capacity after scale back: shippers could purchase additional capacity on the secondary market either through the BGT auction or over-the-counter; they could reduce deliveries at St Fergus and if necessary bring gas in at another terminal; or they could book additional yearly tranches of capacity from Transco. The shippers that took this last option acted at a time when no decision had been taken as to what would happen to their capacity rights with the introduction of the RGTA process. They acted in good faith on the understanding that their booking rights would be honoured.

Transco, by virtue of the delays to its NTS capacity and maintenance programme, were not operating an economic and efficient system at the point that these annual bookings were made and this was reflected in the compensation they had to pay under modification 287. Transco were forced into replacing an inefficient system, as is reflected in the failure of Transco to come up with viable alternatives to the regime in spite of repeated requests from Ofgas. They did not accede to Ofgas’ concept of auctions until May 1999 which was well after these annual bookings were made.

The new capacity regime gives entry capacity a market value - this acknowledges that a different value is placed on entry capacity at different times of the year. Historically, a premium value has been placed on winter capacity due to the seasonality of demand. This is demonstrated by the secondary market for entry capacity which has seen St Fergus capacity traded for free on some days in the summer and for 3 pence per therm on some days in the winter. It therefore follows that the appropriated capacity volumes are worth more than the value set out in Transco’s Transportation Statement, conversely, summer capacity values are worth less.

This means that where companies have made annual bookings that cross the gas year, they have on average “overpaid” for the capacity they have booked up to 1 October and that this overpayment is compensated for by obtaining “cheap” capacity from 1 October until the end of the booking.

Compensation is required for the end dating of capacity rights as this historic form of compensation is no longer available. Therefore companies that responded to the constraints by booking additional annual tranches have been discriminated against.

To explain more specifically the proposed compensation mechanism, shippers with shoulder month bookings of entry capacity should receive compensation from Transco which should be calculated as follows:

$C = Vi * (Pc - Pi)$

Where:

“C” is the daily compensation payable by Transco to the relevant user

“Vi” is the daily volume booked as part of the original annual booking

“Pc” is the average of the cleared prices arising from the four auctions of firm capacity for the relevant month

“Pi” is the price of the original annual booking”

2.Transco's opinion:

The introduction of the NGTA regime has brought fundamental changes to the nature of the capacity services Transco offers and to the means of accessing those services. In the new regime the concept of annual capacity tranches has been replaced with monthly capacity entitlements that are defined as firm and entitle the holder to compensation should the capacity subsequently be unavailable when the User wishes to use it. If the prevailing capacity bookings had not been terminated on 30 September but had been allowed to continue, then it would have been necessary to ring-fence them within the new regime. As the amount of capacity available as ‘firm’ is finite this pre-emption right would have reduced the availability of capacity offered and booked through auctions within the NGTA regime. There is a high likelihood that for most ASEPs and for most months this would have left no capacity available for auction as the pre NGTA regime bookings were not limited to the physical capability of the system.

During autumn 1998, as part of the introduction of Modification 0271 (Interim Capacity Entitlement arrangements at St Fergus), Transco indicated to shippers that the revision of the capacity booking regime was a short term measure to alleviate the neutrality costs associated with St Fergus constraints and that a further revision to the capacity regime in the following year would be likely. The compensation claim put forward by the Proposer does not seem justified given that advance notice had been given to the industry that a fundamental change to the regime would be likely and that an end dating of entry capacity entitlements would probably be required.

The introduction of Modification 0273 ‘Additional Entry Capacity Services’ in November 1998 was considered to represent a significant change in the way that shippers accessed entry capacity services. An end dating of entry capacity was enacted in order that shippers could modify their entry capacity holding. One of the issues raised at the time this modification was implemented (mid November) was the mis-match between the new annual capacity tranche end date and the gas year. However, by the time that Modification 0273 was implemented, the BC99/RGTA discussions were underway and most parties anticipated that a similar end-dating process would be required in October 1999. As a minimum this would restore the synchronisation between the capacity booking year and the gas year.

Modification 0331 ‘Revised System Entry Capacity Regime for Summer 1999’ (May 1999) provided shippers with the opportunity to revise their entry capacity holdings for the period up to 1 October 1999. This modification permitted shippers to reduce their capacity registration and therefore their liability to pay entry capacity charges for the summer period.

This issue considered in this proposal had already been raised as part of the consultation on Modification Proposal 0314 (RGTA Capacity) and Transco provided its views in the Final Report. Modification 0314 was subsequently approved and implemented on the basis that a compensation package was not considered appropriate and there have been no additional arguments forwarded in support of a compensation claim.

In addition, the Network Code is a changing contract with all parties aware of this risk. Modifications to the Network Code are justified in order to develop the regime to better achieve the relevant objectives. If on each occasion the commercial regime entered a new phase, there followed liability and compensation claims from certain parties that believed they had suffered individually, this could seriously impede development of the contractual framework to the detriment of all parties.

In summary, Transco does not believe that compensation should be paid for bookings that have been terminated to facilitate the introduction of a more efficient capacity regime. In addition, Transco would emphasise that the revenue from capacity charges forms part of the allowed revenue under the price control formula. This ensures that the total amount paid by shippers does not change as a result of entry capacity auctions, and that the averaging effect suggested by the Proposer will effectively be maintained.

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

The proposer argues that the modification achieves the correct level of compensation for the delays in implementing an economic and efficient capacity system as the proposal offers a market rate of compensation for having effectively overpaid for capacity up to the end of the gas year.

However, in Transco’s view the proposal impedes the fulfillment of the relevant objectives as it could set an unwelcome precedent of allowing compensation claims following changes to the commercial regime. This carries a large potential risk and may impede the further development of the Network Code regime.

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

a) implications for the operation of the System:

No such implications are envisaged.

b) development and capital cost and operating cost implications:

No such implications are envisaged.

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:

Since the modification proposal seeks compensation based on a change in charging methodology for entry capacity, then these compensation costs would represent a reduction in the capacity revenue within the price control. This would be recovered through transportation charges.

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

If the proposal is approved, the compensation mechanism would have an effect on the level of under/over-recovery.

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 modification proposal, if implemented, would increase the level of contractual risk to Transco as the compensation mechanism has been proposed retrospectively and as such undermines the Network Code and acts as a disincentive to further development of the capacity regime.

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

No such implications are envisaged.

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

The proposal, if implemented, would allow those Users holding entry capacity at St Fergus which believe they are paying more for entry capacity under the NGTA regime to make a claim for compensation fromTransco.

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:

No such implications are envisaged.

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:

No such implications are envisaged.

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

Advantages:
Recompenses those shippers that have bid for entry capacity at prices higher than the previous published rates for capacity.

Disadvantages:

Undermines the principle of allocation of capacity via auctions based on shipper valuation

Provides compensation in an arbritrary manner so that shippers that have purchased capacity at a low bid price would also be entitled to compensation

The funding of the compensation mechanism would effect the level of 'K' and may lead to instability in transportation charges

Increases commercial risk arising from developments in the Network Code regime

Applies to St. Fergus only and potentially could be seen as discriminatingagainst Users holding entry capacity at other ASEPs.

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.

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 Licence:

No such change to the methodology is anticipated in respect of the modification proposal.

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

There are no modifications required to the UK-Link Systems and therefore a programme of works will not be required as a result of implementing the Modification Proposal.

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

The proposal is to compensate shippers for any capacity holding that extended beyond October 1 1999. A timetable to deliver payments to shippers will be required if this proposal is approved.

16. Recommendation concerning the implementation of the Modification Proposal:

Transco does not support the view that compensation claims are due following introduction of a change to the entry capacity regime which has been supported by the industry and as such does not recommend implementation of the proposal.

17. Text :

Transco will provide legal text if directed to implement the proposal.

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: 10/12/99