Modification Report
URGENT Modification Reference Number 0363

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 because the measures described in the proposal affect the availability of capacity at sites including storage facilities and usage of these sites may be required at any time during the winter period. The earliest time that this proposal could be implemented is from 1 November 1999.

2. Procedures Followed:

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

Proposal circulated 15/10/99
Representations closed out 21/10/99
Report to Ofgem26/10/99
Ofgem decision expected27/10/99

3. The Modification Proposal:

This proposal will permit shippers to transfer a monthly capacity holding from one ASEP to another related non-MSEC ASEP. The process will be as follows:

A shipper will offer to surrender a monthly capacity entitlement for an ASEP to Transco at zero price. A Capacity Surrender offer (Day Ahead Buy-back) will be entered by Transco on behalf of the shipper into the appropriate daily capacity surrender auction at zero price. Transco will enter a Daily System Entry Capacity (buy) bid for a corresponding amount of capacity at the requested (non-MSEC) ASEP at a fixed price of zero. The DSEC fixed price auction will be processed to allocate the requested Daily System Entry Capacity to the shipper.

The capacity surrender and purchase transactions will appear as invoice items at zero charge. The zero price transactions ensure that the revenue share mechanism is not affected. The surrender of capacity at the related ASEP means that the overall risk of curtailment of capacity is unaffected. The capacity allocated under this transfer will be classified as Daily System Entry Capacity and is subject to a rebate payment if scaled back under a Firm Curtailment Factor. The transferred capacity will not entitle the holder to any revenue or cost share at the non-MSEC ASEP.

This process will only allow a capacity transfer to those ASEPs where no Monthly System Entry Capacity has been previously offered. The related ASEPs that may be considered for capacity transfers are; St Fergus to Glenmavis LNG, Barrow to Partington LNG, Barrow to Burton Point, Teesside to Hornsea, Teesside to Hatfield Moor, Easington to Hornsea, Easington to Hatfield Moor, Theddlethorpe to Hornsea, Theddlethorpe to Hatfield Moor, Bacton to Isle of Grain LNG, Bacton to Wytch Farm, Bacton to Avonmouth LNG, Bacton to Dynevor Arms LNG. The amount of capacity that may be transferred between ASEPs will be subject to limitations dependent on System capability.

This process will only permit a surrender of whole month tranches of capacity between the two specified ASEPs.

4.Transco's opinion:

Transco recognises that there are some Users that wish to secure capacity in monthly tranches at ASEPs where no such capacity was determined according to the prevailing methodology. This proposal would amend the arrangements introduced by RGTA, and provide a mechanism for Users to secure a guaranteed allocation of capacity for each day in a month without altering the risk/reward profile of the NGTA capacity regime for all other Users. The proposed facility can only be provided by means of a manual work-round in the timescales required and so the extent of the service must be limited.

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

The availability of a secured amount of daily capacity for every day of a month at an ASEP may permit Users to better manage the price risk associated with daily capacity services through the D-1 process.

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

a)implications for the operation of the System:

A transfer of capacity entitlements within the overall SND levels would not be expected to lead to a change in operation of the system.

b)development and capital cost and operating cost implications:

No additional development of systems required. Some additional manual work-rounds required with consequent incremental manpower 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:

The extent to which this service is required by Users is unclear. If there are few requests for transfers then costs are execected to be modest.

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

Transco believes that no change to price regulation was anticipated by the proposer. However, representations received suggest that implementation may re-open issues considered in PC48 and PC49.

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:

Transco does not anticipate that implementation of this proposal will change the level of contractual risk.

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

No further development requirements identified.

9. The implications of implementing the Modification Proposal for Users:
Users will have the opportunity to secure a guaranteed daily allocation of capacity at ASEPs where no Monthly System Entry Capacity has been made available.

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 this proposal would provide that certain entry points, currently without MSEC, may receive a predetermined allocation of DSEC as a result of a capacity transfer. This may be beneficial to users of such entry points and therefore also welcomed by operators of storage facilities or other non-MSEC entry points.

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:
Transco is not aware of any.

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

Advantages :
Permits shippers to obtain ‘monthly’ capacity at non-MSEC sites
Does not increase risk of scale back at any ASEP

Disadvantages :
Manual work-round required to facilitate transfers
Additional complexity in daily processes
Transfers limited to certain ASEPs only
Transfers limited to monthly tranches only

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

Representations were received from the following; Aquila, BG Storage (BGSt), British Gas Trading (BGT), BP Amoco (BPA), Enron, Mobil Gas Marketing (MGM), National Power (NP), Powergen (P), Quantum (Q), Scottish Power (SP), Scottish and Southern Energy (SSE), Shell Gas Direct (SGD), TXU Europe Power and Energy Trading {formerly EPETL}, Yorkshire Energy (YE). Of the 14 , there were 8 representations in support of the proposal, 5 against and 1 that was 'not fully in support'.

SSE do not support the proposal as it believes that it would give priority to certain shippers when Transco allocates Daily System Entry Capacity

YE strongly support this proposal and believes that it better fulfils the relevant objectives, particularly with respect to the economic and efficient use of the system. Enron argues that implementation of the proposal will affect shippers' commercial positions and that while this is not unprecedented for Network Code Modifications, such a change should only be made if it can deliver benefits that contribute towards the achievement of the relevant objectives. Enron does not consider that the proposal is justified against this criteria.

MGM, BGSt and Aquila support the proposal but only as a short term measure. TXU also feels that a more appropriate solution should be sought, preferably before the next round of monthly auctions (in February 2000).

SGD argues that the relationships between different entry points are not fully understood by the industry and the proposals introduced on 1 October reflected this. SGD does not consider that the underlying issues that provoked this proposal can be addressed through a short consultation. Enron and BGT both point out that the absence of MSEC at non-beach entry points was identified before Modifications 314 and 350 and Pricing Consultations 48 and 49 were agreed by Ofgem. Both argue that it would be wrong to now change the rules on which the regime has been founded. BGT argues that the rules for the capacity regime should not be changed until Ofgem has conducted its review of the winter and should not be implemented until the next capacity booking period in early 2000.

<u>Timing of processes</u>
MGM and Q believe that the proposed facility should be extended to permit transfers for every day up until 13:00 hrs on D-1. SSE believes that the proposal is unduly restrictive as it only permits transfers of whole month tranches of capacity between the ASEPs.

Transco has advised the proposer that as the facility proposed can only be provided by means of a manual intervention into the automated RGTA processes and so it is not possible to introduce any greater complexity into the service offered in the short term. The supporters of modification 358 identified the absence of monthly capacity entitlements at some ASEPs as a significant flaw in the NGTA regime. With some slight additional complexity this proposal would nonetheless provide a mechanism for

Users to establish a similar degree of certainty of monthly entitlement at non-MSEC ASEPs to that available at the ASEPs where MSEC was made available.

TXU asks for clarification as to the timing of requests for Transfers. Transco believes that a capacity Transfer for a month should only be available up until M-3. This would dovetail with the current last time to acquire MSEC through the ‘first-come’ sale mechanism. There is merit in restricting all transfer requests to a single window for applications as otherwise it can be argued that shippers using this facility have an unfair advantage in using the System flexibility to meet their own gas sourcing objectives.

As stated above, Transco believes that the extent of this proposal must be limited as it would rely on manual interventions into the automated RGTA process. As the auction processing timetable is already congested it is not possible to include any significant additional workload without extending the time to allocate entitlements beyond 15:00hrs D-1.

<u>Related ASEPs / Transfer amounts</u>
Q correctly points out that the related ASEPs identified in the proposal appear to be coupled based on regional flows/constraints but asks why capacity transfers must be carried out on this basis. BGSt urge the introduction of the THREAD entry point ‘which would resolve the issue for Hornsea and Hatfield Moor’. NP does not think that Teesside should be necessarily be regarded with Hornsea. SSE considers that Teesside is as much linked with Partington LNG as Barrow. NP also queries how the system capability will be evaluated in determining whether whole month tranches of capacity may be transferred. BGT is concerned that the pre-emption rights to daily firm capacity that would be introduced under this proposal could exceed the capacity of the non-MSEC ASEP. Enron argues that the pairing of ASEPs reflects normal operational constraints but that constraints can also arise between the pairs. If the level of constraint between any pair of ASEPs is a matter of degree then Enron views as discriminatory any arbitrary limitations on the determination of the pairs of ASEPs between which capacity may be transferred.

The proposal links pairs of related ASEPs for the purposes of capacity transfers. The pairs represent ASEPs where there is a clear interaction. It may be argued that to some extent all ASEPs interact and therefore have some transferability. However, the pairs that have been identified are clearly linked through the pipeline network and typically also share a geographical location. These groupings have been chosen so that there is a ‘one-for-one’ exchange rate between ASEPs that share a common constraint point. For example, if one unit of firm capacity is surrendered at Easington then it is possible to ensure the release of one unit at Hornsea. This same rule would not necessarily apply between Bacton and Hornsea as the two ASEPs are much less likely to interact and are on opposite sides of the Hatton constraint point. There is a limited amount of interchangability between Teesside and Hornsea. These points, situated on the East coast share the Hatton constraint but in addition there are potential constraints between Teesside and the Easington / Hornsea area which would limit the amount of capacity that might be transferred.

The extent to which transfers are permitted should be determined by reference to the physical constraints of the System. Transco agrees that it would be perverse to permit transfers that cannot then be physically delivered. BGT identifies that a set of rules, agreed by the industry, must be established to govern decisions on the acceptability of transfer requests. It may be appropriate to have a level below the physical maximum to limit the amount of capacity that may be transferred in to an ASEP. Without such limit the situation may arise for a particular day that there is little or no capacity available for ‘normal’ daily bidding. There is some difficulty in setting such a limit to deliver a sufficient amount of capacity for transfer and also sufficient access to daily services.

In addition, Transco has identified that a mechanism will be required for situations where an ASEP has already ‘received’ its maximum allowable capacity under the transfer mechanism. Under this proposal it would be necessary to apply a ‘first-come’ approach to requests for transfers.

<u>Revenues and reserve prices</u>
SGD argues that shippers did not acquire entry capacity at terminals on the understanding that the capacity could possibly give access to storage capacity in any months in which storage capacity was valued more highly.

TXU asks for confirmation that the floor prices for daily auctions at non-MSEC sites will remain unchanged. Transco confirms that is the intention of this proposal. Transco understands that the mechanism proposed, to ensure that for each day of the transfer month an amount of daily capacity is allocated, was suggested because it does not lead to the ASEP becoming an MSEC ASEP with the different reserve price methodology that would then apply.

Enron argues that the proposed transfers are discriminatory and illustrates this by comparison of the LRMC costs for capacity. It argues that LRMC was used as the basis for deriving reserve prices. These prices vary between ASEPs and importantly, are lower for Theddlethorpe than for Hornsea. Implementation of the proposal would allow the transfer in of ‘cheap’ capacity from Theddlethorpe and Easington to the relatively more expensive Hornsea ASEP. Enron argues this is a blatant undue discrimination.

BGT argues that implementation of this proposal would involve a shift towards overselling of MSEC. It identifies that where there where an entry point normally has a zero contribution towards meeting the SND demand it would be wrong to allocate MSEC. SGD finds that the proposal is unclear on the effects on neutrality and on Transco’s regulated and unregulated revenues. NP suggest that in the event that capacity is transferred, the shippers registered MSEC should not reduce as otherwise any share of capacity related costs would be underrepresented.

Transco confirms that a surrender of capacity does not cancel a shipper’s registered capacity holding but does affect its available capacity entitlement. Implementation of the proposal will not lead to an overselling of MSEC as the surrender of MSEC capacity at one ASEP and corresponding transfer of DSEC to another ASEP must be equal. The shipper is still liable to pay for the registered (MSEC) capacity at the original ASEP and to participate in the neutrality mechanism. The process proposed, to conduct surrender at all locations at zero price, would ensure that the net effect of the capacity transfer on the incentive mechanism is nil and that neither revenues nor costs for other shippers are generated as a result of its operation. The regulated revenue would remain unchanged from the anticipated amount as a result of the MSEC auctions.

TXU also asks for assurance that Transco that sufficient amounts of entry capacity will be made available at non-MSEC sites to ensure that Shippers are able to meet demand. Transco will continue to operate in the manner appropriate with the incentive mechanism. In the event that System Entry Capacity is limited the prices being bid and/or offered for capacity will guide the allocation between ASEPs. This mechanism allows Shippers to indicate where capacity is valued for a day. It may be the case that if a significant amount of capacity has been transferred to an ASEP then the availability of additional Daily capacity will be limited and that this may increase the volatility of prices at such ASEPs.

Discrimination

BPA, Enron and SGD argue that the implementation of this proposal, which would provide some shippers with flexibility that is not being made available across all entry points would discriminate between different shippers and different entry points. Enron supports the concept of flexible entry for all entry points and argues that it would address the concerns of the supporters of this proposal in a non-discriminatory fashion.

BGT argues that implementation of this proposal would confer flexibility on certain entry points for transfers to related ASEPs. This changes the basis of the service that has been sold and ‘would enhance the value of such capacity to certain users if they were able to transfer it to other entry points.’ BGT argues that this may be discriminatory to shippers that do not have capacity that may be transferred to the non-MSEC entry points or those that would have judged their requirement for MSEC differently if the facility proposed now had been envisaged when bidding for MSEC.

Transco Response:

Transco is sympathetic to the situation faced by some shippers that they are unable to obtain monthly tranches of capacity at certain ASEPs where they perceive a need for such a service. Transco views the proposal as a compromise solution to a difficulty identified within the RGTA regime. However, there are issues associated with the implementation of this proposal, particularly those associated with changing the nature of the MSEC service and introducing additional services for some selected points, that remain outstanding. On balance Transco believes that in the light of the cornerns raised in representations, implementation of this proposal as a temporary measure would bring difficulties that outweigh the advantages.

The methodology that was implemented under modification 350 was a result of thorough consultation and provided a compromise between complexity and transparency. The absence of MSEC at some entry points was recognised and a different treatment for the setting of daily reserve prices reflects this. Ofgem stated in its decision document that a review of the methodology would be undertaken and, if necessary, changes proposed. Transco acknowledges that the concept of flexible entry is worthy of further consideration within a more thorough review of the mechanism for allocation of MSEC can be conducted in spring 2000. Transco believes that the complex and interrelated nature of the issues are best addressed through a review such as that signalled by Ofgem.

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:

A programme of works is not required

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

As Transco does not recommend implementation a timetable is not proposed.

18. Recommendation concerning implementation of the Modification Proposal:

Transco does not recommend implementation of this proposal.

19. Transco's Proposal:

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:

<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 **0363**, version **1.0** dated **26/10/99**) be made as a modification to the Network Code.

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

Signature:

Director of Transportation Regulation

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.