Final Modification Report
Modification Reference Number 0365
Availability of Within Day Capacity

This 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 Users 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 summarised 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 1/24th 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.

Users will be able to place bids for Daily System Entry Capacity (DSEC) in respect of any gas day. Users 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 Users within day bids should be expressed as end of day quantities and that Users 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.

Users 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 .

Users 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. Users’ 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 addition 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 Users’ 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 Users 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 Users 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 Users 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. Tranco’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 were contained in pricing consultation paper PC51, and the specific price implemented will be subject to the outcome 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 Users 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 Users 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 Users 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 would be more closely aligned with shippers' desire that Transco maximises the level of capacity it makes available.

- There would be a reduced incentive to potentially seek 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 be settled at 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 Users’ are fully aware of the start date 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 would help to ensure that the available transportation capacity can be allocated between Users’ 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 Users’. This proposal would allow Users’ greater control over their capacity rights by increasing the within day “firmness” of the service. This may provide a better platform for Users’ 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 would represent a change in the way Transco optimises and makes available entry capacity. Other than to address market failure, it would 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 would 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 is incurring significant IT development costs associated with the potential 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 would 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 to recover 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 would not be 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 would be incorporated into any 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 Users would also require development to handle the increase in complexity and provide an improvement in response times as deemed necessary.

Transco's potential 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 Users 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. <u>The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Storage Operators, suppliers, producers and, any Non-Network Code Party:</u>

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. <u>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</u>:

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

10. <u>Analysis of any advantages or disadvantages of implementation of the Modification Proposal:</u>

<u>Advantages</u>

i. Allows Users 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 Users place on capacity

iv. Potentially increases liquidity in secondary trading of capacity , due to reduction of interruptible capacity

<u>Disadvantages</u>

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 resulted in Users 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):

Transco received 18 representations on the draft modification report.

Of these, the following five respondents express support for the proposals :

Association of Electricity Producers	(AEP)
Aquila Energy	(Aq)
Total Gas Marketing	(TGM)
Scottish Power	(SP)
Enron	(En)

The following eleven respondents do not support the proposals :

Agip (UK) Limited	(AGIP)
Amerada Hess	(AH)
BP Amoco	(BP)
British Gas Trading Limited	(BGT)
Elf Gas and Power	(ELF)
Dynegy	(Dy)
Scottish and Southern Energy plc	(SSE)
Shell Gas Direct	(SGD)
National Power	(NP)
Quantum Gas Management	(QGM)
Yorkshire Energy	(YE)

The following two respondents give no overriding view on the proposals :

TXU Europe Energy Trading	(TXU)
Alliance Gas Limited	(AGL)

The issues raised within the representations are grouped below under the following headings;

i. General
ii. Interruptible Service
iii. Capacity Levels of Firm Capacity
iv. Overrun Charges
v. Specification of Auction
 - Timings of Auctions
 - Open Bid / Sealed Bid Process
 - Payment Method
 - Reserve Prices
 - Incentive Mechanism
vi. Miscellaneous

General

Many of the respondents not supporting the proposals nonetheless express support for the principles of Modification Proposal 0365 and acknowledge the benefits of the provision of a 'within day' capacity market. However, they have concerns with the service Transco is proposing to offer and believe that it goes beyond the original intention of the modification proposal. These concerns centre on the reduction of the levels of interruptible capacity made available, the effects this will have on the costs for capacity faced by Users and liquidity of the OCM, the added complexity the service brings, and that it does not deliver the service that Users require.

A number of respondents comment on the modification process as applied to Modification Proposal 0365, with AH, SGD, and SSE suggesting that there has been insufficient time for the industry to give due consideration to all the related modification proposals under consideration and their interactions. Five respondents (TXU, SGD, AH, SSE, QGM) express concern with the process as adopted for the development of this shipper raised proposal and state that the Development Workgroup and Draft Modification Reports do not fully represent the views expressed by shippers. TXU state that this is noticeable with regard to interruptible capacity where the majority of the workgroup did not concur with Transco's view.

AH believes that the proposal has the potential to increase costs to shippers, and hence end-users, and that it unnecessarily adds a piece-meal approach to development and implementation where a period of stability to review progress would be preferred.

SSE sees little value in the service as it does not facilitate shipper to shipper trading.

BGT is of the view that the proposals allow Transco too much control of when, and in what quantities, it releases capacity.

SGD and AGL argue that it is not practical for Users and Ofgem to consider such significant changes, including other related urgent modification proposals, so close to the forthcoming auction of entry capacity.

One respondent (YE) supports the proposed start date of 1 June. Three respondents (AEP, BP, NP) express concern with this date for reasons of end-users contract renewal dates, the need for more time to develop business rules further (suggesting a start date of 1 October), and that it provides little time between a decision on implementation and the forthcoming auction. A delay to the proposed start date is suggested.

Interruptible Service

Thirteen respondents express concern with the proposed reduction in the levels of interruptible capacity to be made available and believe that the current levels should be retained, including both "Use-it-or-trade-it" and incremental interruptible capacity. They argue that this is required to prevent capacity hoarding (BP, YE, Aq, SP), and that a reduction in availability will introduce additional risk for Users, will reduce liquidity in the trading markets and will subsequently increase the OCM costs due to the 'factoring in' of potential overrun costs. One respondent (TXU) suggests a limited reduction in interruptible availability (no greater than 25%) such that the effects on the OCM can be determined prior to assessing whether levels can be further reduced.

Two respondents (Aq, TGM) support the proposed reduction in the levels of interruptible capacity on the basis that the prevalence of significant quantities (of interruptible capacity) has undermined the value of firm entitlements.

A number of respondents comment on the link with Transco's proposed reserve price for daily capacity, arguing that if the interruptible levels are reduced then there should be no reserve price. Dy comments that the proposal would reduce shippers' access to capacity at market-related prices, with SGD stating that it puts greater reliance on Transco bringing all the capacity to the market. ELF suggests it will place further pressure on the incentive package to operate effectively. SGD further argues that other factors have created a lack of liquidity in the market which a reduction in interruptible levels will not address. ELF argues that the ability to purchase the current interruptible service, which is not dependent upon signals generated by the incentive regime, promotes efficient utilisation of the network.

Capacity Levels of Firm Capacity

YE expresses concern over how Transco chooses to allocate entry capacity between competing terminals and believe the allocation profiles may not be the most economic. SGD is of the view that Transco is not well placed to assess what quantity of capacity should be made available, and that the daily capacity made available should vary with demand on the system and the levels of monthly capacity. En argues for greater control and auditing of the volumes of firm and interruptible capacity Transco makes available, starting with Transco publishing its estimate of the capacity available both on D-1 and within day.

Overrun Charges

TGM and Aq express support for the proposed change to the overrun regime with TGM expressing concern with the suggested two tier regime on the basis that it would be difficult to define a constraint and would add unnecessary complexity. YE expresses support for a possible two tier regime. SSE believes that overrun charges have not been discussed in sufficient detail, and that they need to be reviewed as the solution implemented in October 1999 was a temporary one. SSE also requests confirmation that Transco intends to release details of the highest offer prices in order that Users can calculate any potential overrun charges.

Specification of Auction

Timing of Auctions

TXU acknowledges that the time involved in assessing the capacity availability within day restricts the frequency that Transco can go to the market, but requests that the frequency is increased if the processes can be improved. AGL believes that Transco should commit to processing the bids within one hour following each auction, which would reduce uncertainty among Users in respect of their supply and demand position. En comments that Transco's proposed discretion in determining when it conducts a "capacity allocation", and lack of information over the volumes of capacity will create significant uncertainty for Users. It proposes that Transco should, at all times within day, post offers to make additional entry capacity available on a "first come first served" basis which will remove any delay in the capacity allocation process.

Open Bid/Sealed Bid Process

Five respondents (AGL, TGM, SSE, SP, YE) express support for Transco's proposal to provide the prevailing bid list, on an anonymous basis, at both the day ahead and within day stages to improve the level of information provision and transparency. Two respondents (Aq, BGT) argue for the retention of "blind bidding" since with open bidding Users will need to assess competitors bids and update their bids continually. This could drive up the price of day ahead and within day capacity as real time approaches.

Payment Method

Aq and TGM express support for the pay-as-bid principle as it discourages spoof bidding and it incentivises Transco to maximise the amount of capacity it releases.

SGD and QGM do not support the proposed pay-as-bid method with SGD expressing concern that it will not prevent high bids from setting unreasonable overrun prices. SGD also query how the arrangements will better facilitate Transco's relevant objectives. QGM believes that the proposed method will increase Transco's income and argues that this can be justified only if Transco has under-recovered in the present regime. Analysis is requested to justify this.

Reserve Prices

Four respondents (Aq, NP, AH, SSE) argue that there should be no reserve price for daily firm capacity. AH argues that the debate over the floor price can not be sensibly concluded until the issue of within day interruptible capacity is resolved. It further argues that, in the absence of a floor price, a capacity trading market becomes more liquid and reveals a true product value and that Transco is using these proposals, in this respect, to increase its capacity revenues. NP suggests that removing the daily floor price would not necessarily shift shipper demand from monthly to daily capacity as Users will still seek value and certainty in the long term capacity auctions. It argues that maintaining a daily floor price and removing interruptible capacity will drive up the costs of capacity.

SP and Dy are of the view that the proposed reserve price is too high, with TGM welcoming the proposals contained in Pricing Consultation Paper PC51.

Incentive Mechanism

BGT is of the view that the proposed incentive mechanism incentivises Transco to minimise the quantity of capacity released as this is likely to raise the prices bid by Users, thus, it argues, maximising Transco's unregulated revenue and resulting in increased costs to Users.

Miscellaneous

Three respondents (TXU, TGM, SSE) comment on the contingency plans put forward by Transco with TXU and SSE suggesting that, in the event of a systems based failure, a fax based contingency should be introduced to encourage Users to place bids thus possibly avoiding the need to invoke "failure to accept gas" provisions. SSE suggests that the compensation methodology for scaling back is revisited as well as the extent to which Transco picks up these costs. It believes that Transco's concerns about market failure are premature as Users will always be prepared to offer capacity to Transco, at a price. TGM agrees with the proposed provisions.

AGL and YE welcome the opportunity to be able to register capacity trades on the RGTA system, and to view the net within day position. Further simplification in the operation and administration of the system is also requested.

SSE urges Transco to publish indicative firm and interruptible capacity levels for each ASEP prior to the close of the day ahead auctions, and Aq welcomes Transco's proposal to provide such information. AGL suggests further discussion is needed regarding the interaction with the overrun regime and information provision.

Aq, SSE, and SGD express concern about Modification Proposal 0378, suggesting that it would be preferable to conduct the monthly auctions in two tranches, to reflect the two regimes, for the periods April to May and June to September.

YE requests assurance that Transco's systems do not suffer time lags where larger Users are inputting large quantities of bids. It suggests that the most significant improvement in the regime will be the linkage of capacity to hourly rather than end of day flows.

QGM requests research to be undertaken into the amount of interruptible capacity that would be made available following the delayed introduction of this modification. SSE requests details of how Transco proposes to support the service and of any cost benefit analysis, and welcomes any notice of changes to invoicing procedures.

Transco Response:

General

Transco welcomes the fact that the majority of respondents support the concept of within day capacity in allowing Users to adjust their capacity position within day and for Transco to make additional capacity available. Of those respondents which do not support the service as proposed by Transco, the main concern centres on the proposed reduction of the levels of interruptible capacity available which is discussed later.

Transco acknowledges that the timetable for consultation and due consideration of the current range of RGTA related Modification Proposals has been demanding, but it has considered this pace necessary to ensure that all aspects of the regime are in place prior to Users bidding in the next round of MSEC auctions. Transco believes it has correctly applied the rules of the modification process in facilitating the development of the modification proposal and has sought to represent shippers' views in the Development Workgroup report. In particular, Transco is of the opinion that Users views on the proposed reduction in availability of interruptible capacity, and the effects this will have, were clear in both the Development Workgroup Report and the Draft Modification Report.

Transco recognises that the proposed within day capacity service would introduce further changes and new processes at a time when the industry is still gaining familiarity with the changes introduced in October 1999. However, it believes that the within day market is a desirable enhancement to the NGTA rather than a major reform, and that it removes some of the previously identified interim features of the present regime. The two most notable interim features are the option to scale back firm capacity within day and the release of large quantities of interruptible capacity on D-1. Both of these facilities were introduced as a result of there being no within day market to ensure that increases and decreases of capacity within day could be managed through a market based mechanism. Many of the features proposed within Modification Proposal 0365 were discussed during the RGTA process in 1999, but could not be accommodated as part of the October 1999 changes. In this sense, implementation of this Modification Proposal might be regarded as completion of the October changes to the capacity regime.

In respect of the costs shippers would face were the Modification Proposal to be implemented, Transco believes that a principle advantage of a within day market is that shippers would be able to fine tune their capacity needs as the gas day progresses and therefore achieve a closer match between their level of capacity holdings and delivery requirements. This, in conjunction with Transco's proposed reduction in the reserve price for daily firm capacity, should offset any reduced availability of interruptible capacity - a notable feature of the existing regime is that quantities of interruptible capacity in excess of actual deliveries have been purchased on most days. This proposal would also provide greater control of costs for Users where capacity availability reduces within day. Instead of being exposed to a uniform scale back, they would be able to realise their value for capacity by offering it to Transco via the within day market

Transco has consistently argued that it does not believe it is its role to facilitate shipper to shipper trading but, prior to any potential future establishment of a market run by a third party, it has agreed to provide a bulletin board facility where Users can advertise that they wish to buy or sell capacity to other Users.

Transco has indicated during the development of this proposal that it would seek to release capacity for a number of reasons before and during the day. These are changes in demand, changes in the availability of both onshore and offshore plant and where the buying and selling of capacity would be beneficial to Transco through the operation of the capacity incentive scheme. It is not possible to give specific undertakings on the times and quantities regarding the proposed capacity releases due to plant changes or the incentive. However, it is anticipated that, if necessary, capacity will be bought and sold by Transco immediately after demand attribution. Transco would continue to both sell and buy capacity at approximately the same times as it does at present on D-1.

Transco recognises the pressing nature of the timetable for this and related Modification Proposals and the commencement of the April to September MSEC auctions. However, it believes that it is important that Users are aware of all aspects of the regime prior to bidding in the next round of auctions. This view has been endorsed by a number of industry representatives at Workgroup meetings and has necessitated this challenging timetable. In addition, Transco considers a further delay beyond 1 June is not warranted since the measures set out in this proposal have been debated at length and were identified as desirable future developments prior to October 1999. Any delay would also limit the experience and knowledge gained in the new regime and reduce the scope for refinements to the service prior to the forthcoming winter period.

Interruptible Service

The main feature of the proposed service that has attracted concern is the proposed reduction in the availability of interruptible capacity. Transco has argued that the levels of interruptible capacity made available to date, coupled with the supply/demand position since October 1999, has meant that Users have potentially enjoyed a firm service at an interruptible price. It should also be noted that the provision of interruptible capacity up to the “1 in 20” peak level was not originally a feature of the proposed RGTA regime. It was introduced as a late change to take account of increases in capacity availability within day which could not be released in the absence of a within day market. Transco has argued that that this potentially undermines the value of firm capacity, restricts trading of daily capacity and, if the present quantities continue to be made available, could introduce a risk of Users reducing the levels of bookings sought in future auctions of MSEC. Transco is of the view that while Users are able to hold relatively low cost interruptible capacity in significant quantities, a within day market could be lacking in liquidity and unable to develop.

Transco, however, recognises that total removal of incremental interruptible capacity could cause Users to factor the perceived risk in to their OCM bids, thus potentially increasing costs. In response to the concerns raised in representations, Transco proposes that, if this Modification Proposal is implemented, it should continue to make interruptible capacity available on a "use-it-or-trade-it" basis and to make available on D-1 an amount of interruptible capacity at each ASEP equal to 10% of the MSEC availability at that ASEP. This would be as a transitional measure until 30 September 2000 in order to allow for further evaluation of the role of interruptible capacity when provided in conjunction with the proposed within day capacity mechanism.

In respect of reserve prices, Transco has recognised that a reduction in the availability of interruptible capacity may increase costs to some Users and has therefore put forward Pricing Consultation 51 which proposes a reduction in the multiplier applied to daily firm capacity from 1.5 to 1.25. In the light of representations received, this has been further reduced to 1.0. Transco believes this could offset any possible increased costs arising from the reduction in the availability of interruptible capacity.

Levels of Firm Capacity

In some cases the availability of incremental capacity may be limited to one ASEP. In such circumstances Transco would propose to allocate capacity to those who value it most highly. Where capacity could be made available at more than one ASEP, Transco would again propose to allocate capacity to those that value it most highly but would compare bids at all ASEPs where the additional capacity could be made available. Transco believes it is well placed to determine the availability of capacity as it is in possession of a wide range of information such as aggregate demand, demand distribution, NTS plant availability, non NTS plant availability and shippers expected nomination requirements.

Transco does not support the view that greater control and auditing is required since the incentive mechanism is designed to ensure that Transco receives a financial benefit for the release of additional capacity to those who value it most, and to ensure that capacity which has been previously sold is available to the extent that Users wish to utilise it.

If the Modification proposal is implemented, Transco would propose publishing its forecast of daily firm capacity to provide greater transparency to this process.

Overrun Charges

Transco does not support the concept of a different overrun regime applying on constrained days since it is not clear which regime should apply when an ASEP becomes constrained within day. It is also unclear as to why delivery of gas in the absence of capacity should be treated differently based on the condition of the NTS. Transco also believes that the existing regime provides sufficient linkage to the prevailing conditions within the regime by its reliance on the prices at which capacity has been bought and sold and the System Average Price as possible components of an overrun charge. In order to provide Users with prior knowledge of potential overrun charges Transco has agreed to limit the use of capacity prices to D-1 transactions for the calculation of overruns and will publish the relevant prices prior to the gas day.

Specification of Auction

Timing of Auctions

Transco's position regarding the frequency of auctions remains that it proposes to review the level of capacity availability and potentially allocate or buy back capacity after demand attribution times and following changes in the availability of both onshore and offshore plant. Transco would also propose to buy and sell capacity where no aggregate change in availability has occurred where this provides a benefit under the operation of the incentive regime. Transco expects to continually seek to offer the maximum amount of capacity for the prevailing conditions to the extent that Users wish to buy it, but recognises that an important consideration for Users is the speed at which Transco can process bids. Further improvements to its in-house processing systems used for capacity allocation have allowed a reduction in the processing time required and Transco is now in a position to reduce this from two hours to one hour. This will permit earlier notification to be given to Users as to whether or not their bids have been accepted and their capacity position altered.

Transco believes that it would need discretion in determining when it conducts a "capacity allocation" as this can only be effectively executed once an up to date forecast of the capacity availability for the whole system is available. The timing of this can be unpredictable as it is not possible to accurately predict the occurrence of influencing factors such as plant failure.

Transco does not support the suggestion that it should post offers for the sale of incremental capacity. It would be inappropriate for Transco, as the service provider, to offer a price other than the reserve price. This would tend to create a "first come first served" allocation process as opposed to an allocation based on Users valuations.

Open Bid/Sealed Bid Process

The issue of whether Users can view the prevailing bid list, on an anonymous basis, has been discussed at length. Transco welcomes the fact that the majority of Users that commented on this aspect expressed support for the availability of such a facility. Transco acknowledges that it may require additional effort from Users to assess the latest bids and if necessary to make changes to their bids, but the new RGTA capacity system should minimise the time involved in posting bid applications and, of further importance, Transco believes this will promote liquidity.

Payment Method

Transco remains of the view that a "pay-as-bid" approach removes the potential incentive for Users to bid for capacity at a high price in order to push up overrun charges to an artificially high level. A "pay-as-bid" policy also helps further the relevant objectives by providing an incentive mechanism which unambiguously encourages the release of additional capacity, thereby furthering the efficient and economic operation of the system.

The issue of payment method is not connected with any over or under-recovery of transportation revenue since revenue from daily services is not governed by the price control.

Reserve Prices

The level of reserve price to be applied to daily capacity services does not form part of this proposal. However, Transco has recognised that a reduction in the availability of interruptible capacity may increase costs to some Users and has consulted upon a possible reduction in the daily firm reserve price. In the light of representations received for this consultation, Transco has now proposed that a multiplier of 1.0 should be applied to the base price used for the calculation of reserve prices.

Incentive Mechanism

The subject of the most appropriate incentive mechanism is addressed in more detail within Modification Proposal 0382. Transco would suggest that it is unlikely to adopt a strategy of holding back the release of additional capacity in order to drive up the cleared price, and subsequently gain through the incentive mechanism, since this could arguably be regarded as a breach of its statutory obligations. However, moving to a pay as bid approach should remove any financial incentive to withhold capacity.

Miscellaneous

In the event of systems failure, Transco confirms that, if the Modification Proposal is implemented, it would anticipate conducting a limited number of capacity allocations using an alternative facsimile based system. However, the frequency of such allocations would necessarily be reduced.

Transco believes that the compensation levels agreed for "failure to accept gas tendered for delivery" remain appropriate since neither the nature nor likelihood of this occurrence would change as a result of implementation of this proposal.

Transco can confirm that the new capacity registration system is being designed within the RGTA capacity system with a view to simplifying the updating of shippers' capacity positions within day and the provision of new screens and procedures should facilitate its use.

Transco does not support the auction of MSEC for April and May followed by a subsequent auction of MSEC for June to September. The auction process takes a number of days and Transco believes this occupation of industry resources should be minimised. The timetable of this and related Modification Proposals has been designed to ensure that Users can be aware of all aspects of the regime prior to the auction start date and this allows for the auction to proceed as planned for the next six months.

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:

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. Programme 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 Users,
Test linkages between systems,
Implement training programs within Transco and Users,
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. Users 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:

Transco recommends that this Modification Proposal is implemented.

17. 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.

18. 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.

19. Text:

The draft text for Sections B, I, and the Transition Document is attached.

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 **0365**, version **1.0** dated 28/02/2000) be made as a modification to the Network Code.

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

Signature:

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.