Final Modification Report

Modification Reference Number 0373

This Final 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 Modification 0373 Development Workgroup approached this Modification Proposal assuming that the current Shipper balancing tolerance regime would be removed with effect from 1st April 2000 but that the Non Daily Metered (NDM) Forecast Deviation methodology would continue to apply alongside revised tolerance services.

1.1 Summary of Proposals

Based on these two assumptions, following its Workgroup meetings up to and including 19th January 2000, the main proposals in respect of the revised tolerance services are as follows:

i. Transco will facilitate separate long term and day-ahead, pay as bid, auctions of Under and Over Delivery tolerance service,

ii. the funds raised by the auctions and tolerance overrun charges will be regarded as Transportation Revenue,

iii. Transco will provide a facility for Shippers to register tolerance trades, and

iv. calculation of SAP and SMP prices and their use within the cash-out regime will remain unchanged.

At a further Workgroup meeting held on 26th January 2000 it was suggested that the implementation date be deferred to 1st June 2000 in the light of both Transco and Shipper concerns about the risks associated with a 1st April 2000 implementation date.

The Workgroup also agreed the principles that would support the removal of the monthly cap and collar within the Energy Balancing Incentive.

1.1.1 Remove existing Shipper energy balancing tolerances

The Workgroup considered Modification Proposal 0373 on the basis that, in its September 1999 NGTA Conclusions Document, Ofgem had stated that it *"expects to see the complete removal of shipper balancing tolerances on 1st April 2000."* In consequence, the Workgroup accepted that Shipper balancing tolerances would, therefore, be removed from 1st April 2000, with Shippers either opting for zero tolerances or, to purchase a level of tolerance via an auction or through trading with other Shippers.

1.1.2 **Retain NDM Forecast Deviation tolerance.**

The Workgroup also assumed that the NDM Forecast Deviation tolerance would be retained. It concluded that this tolerance needs to be retained since Shippers are unable to determine the direction or magnitude of the difference between the final demand forecast and the gas allocated to its NDM Supply Points and they cannot, therefore, efficiently manage the associated cash-out risk. Retention of the tolerance would therefore retain the protection Shippers have against this risk.

1.1.3 **Transco to provide separate long term and day ahead, pay as bid, auctions of Under and Over Delivery tolerance service.**

1.1.3.1 Definition of tolerance service and method of release

The key elements of the proposals in this area are as follows:

• two types of service will be made available, Under Delivery tolerance and Over Delivery tolerance,

• Shippers holding tolerance services would gain relief against the relevant SMP exposure,

• quantities of tolerance services made available will be profiled to reflect the variable proportion that current tolerances make up in total system demand,

• tolerances will be released via auctions,

• tolerances will be tradable, and

• revenues from primary tolerance release and tolerance over run charges will be regarded as Transportation Revenue,

1.1.3.2 The sale of separate Under and Over delivery tolerance

It is proposed that the tolerance service will feature separate Under and Over Delivery tolerances. This separation will permit Shippers to reflect different values of Over and Under Delivery tolerance and might also facilitate the development of this service to permit Transco an alternative balancing tool. It is proposed that the service will be made available via both long term release (six months at a time) and day-ahead auctions. The quantity to be released will be determined by Transco in accordance with the methodology defined in the Network Code.

1.1.3.3 The split of auctioned quantities between long term and day-ahead auctions

It is proposed that the auctioned quantities will be split between long term and day-ahead with approximately two thirds of the projected

tolerance available being offered in the long term auction. This will leave room for some day-ahead quantities being made available even if the actual Total System Demand is substantially different from the average daily Seasonal Normal System Demand (SNSD) forecast for that month.

1.1.3.4   Determination of the quantity to be released

The methodology for the calculation of the quantity to be released was embodied in the tolerance service Business Rules and was designed in order to retain the profile of tolerance quantities based upon fixed ratios of inputs, daily metered and very large daily metered outputs. The exact quantity allocated may differ marginally from that calculated strictly in accordance with the methodology due to the application of rounding.

In line with this methodology it is therefore proposed that, for the long term auctions, the quantity to be released will be 66% of a "**Monthly Availability Percentage" (MAP)** of the average level of SNSD forecast for each calendar month of the 1999/2000 Gas Year published in Transco's "Transportation Ten Year Statement 1999". The same basis will be applied to future years based upon the relevant Transportation Statements.

MAP is a value which will vary by calendar month to take account of the variation in End User demand profile. Initially the factors are set to release, in total, the quantity which would have been released to Shippers immediately prior to the introduction of the revised tolerance service. Values of MAP, which would apply to this present Gas Year, are given in Appendix 1 of this report. For future Gas Years Transco will publish, in advance, and apply, MAP values which have been updated to reflect:

• the desire, if any, of the community to change the quantity of tolerance allocated to Shippers. This change would have to be introduced through the Network Code Modification Process, and

• changes in the mix of NDM / DM / VLDM in the whole transportation system.

This method of determination serves to profile the tolerance released to reflect the variable proportion that current tolerances make up in total System demand. The level of tolerance released will therefore reflect the level of demand within each Supply Point category.

A bid, and subsequent allocation, for a particular monthly quantity will apply to each day in that month.

It is proposed that quantities released in the day ahead auctions will be the greater of zero and the relevant MAP for that month, multiplied by the 13.00 D-1 demand forecast, less the quantity sold in the long term auction for that day. To retain consistency with the

long term auctions this MAP will embody any changes agreed by the community.

1.1.3.5 Requirement or otherwise of a reserve price in the auctions

It should be noted that Transco has issued a pricing discussion paper on the issues surrounding reserve prices in auctions.

It is proposed that a reserve price of zero be set for both types of auction so that there are no artificial constraints. This position was supported by all respondents to the pricing discussion paper (PD 9).

1.1.3.6 Detail of auction specification

It is proposed that bidding and allocations within the auctions will be based on lot or "tick" sizes compatible with the On-the-Day Commodity Market (OCM), i.e. 100,000 kWh, thereby facilitating a standard product for trading, which is operationally compatible with the OCM. It is also considered that this functionality will simplify systems building, invoice generation and probably reduce potential User input error during the bidding process.

It is proposed that long term auctions for four monthly blocks of each type of tolerance will be held in May 2000 for tolerance months June to September 2000 inclusive. Auctions for subsequent years, for six months at a time, will be held in September and March. The September auctions will release tolerances for the following October to March period. The March auctions will address the April to September period.

The long term auctions will be split evenly into two rounds. Shippers will be allowed to place 20 "live" bids in each auction round. No two bids may be for the same price and the maximum quantity associated with any bid would equal that available in the auction round. Bids must be in whole multiples of 100,000 kWh and allocations will also be made in whole multiples of 100,000 kWh.

It is further proposed that following any scaling of bid quantities, as a result of the allocation process in regard to equal price bids, any pro-rata allocations will be rounded up to the nearest 100,000 kWh. This process of rounding will never allocate a quantity greater than that bid by the Shipper but may lead to a modest over-selling of tolerances. However, it is considered that this limited over-selling is acceptable given the simplification in the allocations process that this allows. Where any monthly tolerance is left unallocated following the first auction round, due to the lack of valid bids, then it is proposed that no further quantities of the relevant tolerance for that month will be offered in the subsequent auction round.

The tolerances allocated to each Shipper for a particular month will apply to each day in that month.

It is proposed that in respect of each Gas Day in which further quantity will be released, a day-ahead tolerance auction for either or both Under and Over Delivery tolerance will be held in the afternoon of D-1. Only one round will be conducted. All other specifications will be the same as for the long term auctions.

1.1.3.7 Invoicing of primary tolerance release

It is proposed that revenues from the long term and day-ahead tolerance auction be considered to be Transportation Revenue. It is, therefore, further proposed that these revenues be invoiced as part of a new Tolerance Invoice for the month in which the tolerance service was used.

Due to the uncertainties surrounding the long term provision of Tolerance auctions it is Transco's intention to utilise the Ad Hoc Invoicing service for invoicing this revenue. This service provides a prompt, efficient and flexible means of responding to industry initiatives. To facilitate invoice validation, Transco intends that the requisite supporting information will be provided in disk format. (See Appendix Four for further detailed Business Rules in this area.)

1.1.3.8 Compatibility with the On-the-day Commodity Market (OCM)

The Tolerance Auction specification details the bid and allocation quantities as multiples of 100,000 kWh. This figure of 100,000 kWh is proposed as it is considered that this would help Shippers to compare the merit of purchasing tolerances against other available balancing options such as "title" trading on the OCM.

1.1.3.9 Requirement for hoarding restrictions

Concern was expressed during Development Workgroup discussions about the possibility of an individual Shipper hoarding the entire tolerance quantity available either in the long term or day-ahead auctions. After consideration of these concerns it is the view of Ofgem that, other than the total quantity of tolerance gas to be allocated, individual Shippers should have no maximum limit on the amount of tolerance to be allocated within the auctions. Ofgem views that regarding the tolerance income as Transportation Revenue will reduce the risk of hoarding and in any event, Ofgem intends to monitor the auctions and take appropriate action where necessary.

1.1.3.10 <u>Retention of funds from tolerance auctions and tolerance over run charges</u>

It is proposed that revenues generated by the proposed tolerance auctions and tolerance overrun charges should be regarded as Transportation Revenue and be invoiced on the same invoice.

In response to the initial Development Workgroup meetings Ofgem has stated in fax correspondence with Transco that *"Transco is remunerated for linepack through transportation charges. As the tolerance service is a proto-linepack service, revenues from this service should accrue to, and be passed back to Shippers, through the price control. This could allow more accurate identification and targeting of costs associated with offering a linepack service in the future.*

It removes a direct linkage between the price paid for the service and the return of revenue to Shippers for the service. This should ease concerns expressed in the development working groups over the abuse of dominant position by making the "effective discount" to large players less clear."

1.1.3.11 <u>Transco to facilitate registration of Shipper tolerance trading</u>

It is proposed that Transco should provide a facility for Shippers to register tolerance trades transacted between two Shippers. Whilst Transco will not operate a within day tolerance market there are benefits that could arise if an alternative operator could facilitate such tolerance trading.

It is proposed that trade registrations will be permitted as soon as possible following the long term auctions and continue through to 03.35 on the Gas Day. No after-the-day tolerance trading will be permitted. On this issue Ofgem responded to the initial Development Workgroup meetings stating, in fax correspondence with Transco, that they are *"of the view that ATDT* (after the day trading) *would undermine the energy regime by discouraging shippers to balance and go against the principle of cost targeting"*.

Registration and subsequent confirmation of a tolerance trade would be processed by Transco and the tolerance holding of the trading parties adjusted accordingly.

It is proposed that Shippers should not be prevented from trading more Under or Over Delivery tolerance than they actually hold and thus adopting a negative tolerance position. However, Shippers should incur appropriate costs if they continue to hold a negative position at the close out of tolerance trading. Such Shippers would therefore incur a charge based on a multiple of 1.1 of the relevant SAP to SMP differential for the Gas Day applied to the relevant

magnitude of the negative tolerance position.

1.1.3.12 <u>SAP and SMP determination</u>

In its October 1999 NGTA Conclusions Document Ofgem states that *"a revised cash-out regime, based on commodity and flexibility prices should be introduced as soon as reliable information on daily linepack and storage prices is available"*. It is proposed, therefore, that the determination of SAP and SMP prices be left unchanged pending further developments and experience gained through operation of the proposed new tolerance regime.

1.1.3.13 <u>Removal of Energy Balancing Incentives Cap and Collar</u>

It is proposed that the current monthly cap and collars placed on Transco's Energy Balancing incentive be removed from 1st June 2000. However, under the current parameters Transco is not able to breach the monthly cap and therefore removal of this cap is academic. Should the collar be breached it is proposed that Transco should continue to pay funds to Shippers over and above the collar amount and at the end of the Gas Year adjust and recover the payments according to Shippers' annual throughput. The sums to be recovered would be adjusted to take into account interest accrued at Barclays Base Rate.

The Business Rules associated with this proposal are attached as Appendix Three together with the associated legal drafting (Appendix Two).

2   **<u>Transco's Opinion:</u>**

Transco supports the proposals put forward in this Final Modification Report.

Transco considers that retention of the current cash-out methodology is appropriate until alternative approaches to establish the within day value of flexibility exist and are proven. Retention will maintain the level of incentive on Shippers to balance their portfolios and maintain the current incentive to deliver any physical gas associated with physical / locational trading on the OCM, thus leaving Transco with a residual balancing role.

Transco also considers that the removal of Shipper balancing tolerances and replacement with tolerance services purchased via long term auctions and day-ahead auctions will reveal the commercial value of such services and therefore enable "unbundling" from other transportation costs. As a result, a market value for these services will be established. This may encourage Shippers to make informed

economic decisions about their intended balancing performance taking account of the costs associated with purchasing a tolerance service or facing SMP exposure.

Basing the quantity of tolerance services to be released in both the long term and day ahead auctions on the demand forecast available at the time of the auction, and matching this with the current tolerance levels applicable to that demand level and likely End User Category mix, allows for the quantity made available to closely match the profile of that available within the current regime.

During Development Workgroup discussions a number of Shippers put forward the view that the quantity of tolerances available should be reduced below that currently available. Indeed since publication of the Draft version of this report an Urgent Modification Proposal (0381) has been raised which proposes the phased removal of Shipper balancing tolerances over a period of twelve months. Application of a multiplication factor is, therefore, included within the legal drafting in support of this Proposal to effect either increases or decreases in aggregate tolerance quantities to be released.

This factor will initially be set to one which replicates the typical level of aggregate tolerance immediately prior to the proposed introduction of the service. In future this correction factor could be lowered to reduce the tolerances made available in the long term and or day-ahead auctions. Indeed in the longer term such factors could be evolved so that the service more accurately reflects the inherent flexibility in the physical transportation system.

Transco supports facilitating a simple registration service as it considers that the provision of a cleared market is not within its remit as a Public Gas Transporter and to provide such a service could prove to be a barrier to the entry of third parties intending to supply tolerance trading services. Transco would welcome the development of an independent market to support tolerance trading and will facilitate this by promoting a standard interface specification.

3 **Extent to which the Workgroup recommendations would better facilitate the relevant objectives:**

The changes to the tolerance regime and the provision of tolerance auctions and trade registration will better facilitate the following relevant objectives:

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

- Condition 7 c) *"the securing of effective competition between relevant Shippers and between relevant suppliers"*.

The key features of the proposals which will help further these relevant objectives are as follows:

i. the removal of existing tolerances and the introduction of the revised tolerance regime will enable unbundling of this service and promote price discovery of Shipper imbalance tolerances,

ii. the availability of tolerances through auctions will provide an additional risk management capability for Shippers,

iii. the introduction of a tolerance trading registration service will facilitate Shipper to Shipper trading of the services, potentially further reducing portfolio balancing costs,

iv. existing Shipper balancing incentives provided by the current cashout regime structure will be retained.

4.   **The implications for Transco of implementing the recommendations, including:**

    4.1   **implications for the operation of the System:**

The removal of bundled Shipper balancing tolerances and replacement, via an auction process, of approximately the same level of tolerances is not considered to have a material impact on the operation of the System. However, should the quantities of tolerance released differ significantly from those currently provided this may have an effect on the quantity and size of Transco System Balancing actions within the OCM, although quantification of the effect is difficult to assess..

Should the quantity released be significantly higher than the quantity currently available this may lead to lower prices in the auctions, which might be followed by increases in the use of such tolerances. This in turn could result in higher levels of Shipper imbalance quantities and an increased role for Transco as Residual System Balancer. The opposite effect might result if the level of tolerances available were reduced.

    4.2   **development, capital cost and operating cost implications:**

Transco will incur IT development costs associated with the provision of the tolerance service auctions and tolerance trading facilities.

There will also be ongoing costs for administration and future maintenance of the systems developed for these recommendations. Pipeline System operating costs are not expected to be affected by the proposed changes.

Further IT system and operating costs will be incurred to capture data, monitor timing of various activities, calculate tolerance overrun charges, and track Shipper tolerance levels.

    4.3   **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:**

Transco does not intend to seek to recover any additional costs resulting from the provision of these services in the present price control period.

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

The recommended changes are not anticipated to have immediate price regulation consequences. Auction and "tolerance overrun" charges will contribute to Transco's Transportation Revenue.

4.5 **The consequence of implementing the recommendations on the level of contractual risk to Transco under the Network Code.**

The proposed changes are not thought to affect the level of contractual risk to Transco under the Network Code.

4.6 **The development implications and other implications for computer systems of Transco and related computer systems of Users:**

The current Shipper balancing tolerances will be removed and replaced by tolerance service auctions to which Shippers will need access. Once allocated via the auction processes, Shippers may also wish to trade tolerance services and will, therefore, need to register these trades with Transco. The auction allocations and any subsequent trades will need to be reflected in Shippers' cash-out calculations.

The new auction processes and trade registration system will be required to interface with existing systems. Computer systems both within Transco and Shipper organisations will, therefore, need to be adapted / upgraded to introduce these proposals. Transco has investigated the effect of these changes to Transco systems and in summary has identified the following system changes:

a. establishment of long term and day-ahead auction mechanisms,

b. automation of tolerance trade registration on receipt of trade details from Shippers,

c. systematisation of Shipper net tolerance position and consequent Shipper imbalance net of tolerance holding,

d. removal of monthly cap and collar on existing Transco Energy Balancing Incentives,

e. removal of current Shipper balancing tolerances, and

f. production of supporting data to new Ad Hoc invoice.

The computer systems of Shippers may need to be adapted to assess and value their tolerance requirements prior to auction bidding or tolerance trading. Shippers may also need to include a means of calculating and checking charges and credits invoiced by Transco as part of the new Ad Hoc tolerance

invoicing items.

Detail of structural invoice changes are included in the Invoicing Business Rules in Appendix 4 to this report.

4.7 **The implications of implementing the recommendations for Users:**

Shippers will be able to purchase from Transco, and trade with each other, balancing tolerances thereby providing a further tool to manage the risks associated with cash-out imbalance exposure. The services proposed will provide Shippers with an alternative to OCM or Over-The-Counter (OTC) gas commodity trading.

This should ultimately benefit all Shippers as those that achieve consistently better balancing will not need to seek to purchase as much tolerance as they are essentially allocated under current arrangements. Shippers, however, that do not achieve tight balancing of their portfolio will be able to bid to secure an increased amount of balancing tolerance thereby protecting them from the risk associated with SMP exposure. Decisions on balancing and tolerance quantities will increasingly become commercial decisions within Users' spheres of influence.

4.8 **The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Storage Operators, suppliers, producers and, any Non-Network Code Party:**

Producers, Storage Operators, Terminal Operators and potentially Connected System Operators may see an increased number of nominations / renominations as a result of within day tolerance trades.

Storage Operators may wish to negotiate agreements with Shippers in order to manage their additional risk exposure caused by the withdrawal of existing tolerances.

If efficiency benefits are achieved, then these may be passed through to consumers.

4.9 **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:**

These proposals are not thought to have consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party.

4.10 **Analysis of any advantages or disadvantages of implementation of the Modification Proposal**:

Advantages

i.   Assists Shippers in managing their exposure to cash-out risks.

ii. Unbundles the provision of balancing tolerances to allow the value of the service to be discovered.

iii. Improves cost targeting of the provision and use of tolerance services.

iv. Incentivises Shippers to balance their own daily inputs and outputs potentially reducing Transco's role as Residual System Balancer.

Disadvantages

i.   May lead to behavioural changes in Shippers which could be of detriment to the regime as Shippers that purchase tolerance may be expected to utilise such tolerances to a greater extent than they presently use their current tolerance allowance.

ii. Shippers presently do not pay separately for their balancing tolerance. Under these proposals Shippers will be required to purchase these tolerances. The cost of securing these services is dependent on auction and trading prices and as such Shippers will be exposed to market fluctuations.

iii. Cost and complexity of the proposed changes may outweigh the anticipated benefits.

i.   4.11 **Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in this Report):**

A total of 15 Representations have been received in relation to the Proposal.

Written representations prior to the release of the Draft Modification Report were received from British Gas Trading Limited (BGT) and Quantum Gas Management plc (Quantum).

4.11.1 Tolerance service specification.

BGT *"considers that Transco should release a single tolerance rather than separate over and under delivery tolerances."*

Transco response:

The provision of both Under and Over Delivery tolerances unbundles the service further than the release of a single tolerance service and also allows Shippers a wider trading opportunity. The split also enables a close comparison to commodity trading and System Balancing actions where trading of each type of tolerance directly affects the party's cash-out exposure to either SMP buy or SMP sell. In future, should an appropriate within day

market develop, Transco can foresee the possibility of developing the tolerance services as an alternative to OCM balancing actions thereby removing the commodity element from System Balancing actions and potentially reducing the magnitude of System Balancing costs.

Issues	Number in	Number
Support for the Modification Proposal	4	11
Implementation 1st June 2000	1	9
Removal of existing tolerance and replace with tolerance services	4	0
Reduce tolerance levels	3	3
Retain NDM forecast deviation tolerance	1	0
Retain existing cashout regime	3	0
Support tolerance auctions	6	0
Support provision of separate Under and Over delivery tolerance services	6	0
Support provision of separate Long Term and Day Ahead auctions	3	0
Support determination of tolerance quantities based on current levels	4	0
Support zero reserve price and 'Pay-as-bid'	4	0
Support trade registration service	5	0
Support 100,000 kWh 'tick' size basis for auctions and trading	4	0
Invoicing of auction revenue concurrent with existing Energy Balancing invoice	3	0
Requirement for Anti-Hoarding restrictions	2	1
Revenue to be redistributed via 'k'	2	4
Remove Energy Balancing Incentive monthly cap and collar	6	0

4.11.2   Removal of existing Shippers balancing tolerances.

Quantum *"does not support a further reduction of tolerances"*.

Transco response:

In its October 1999 NGTA conclusions document Ofgem states that it *"expects to see the complete removal of shipper balancing tolerances on 1st April 2000."* As such the Workgroup debated this issue briefly and accepted that the existing tolerance regime would be replaced with an auctioned service offering a tradable commodity. If implemented Shippers would have the opportunity to purchase the tolerance quantity they require subject only to the aggregate availability of tolerance and the price they are prepared to pay.

Following the issue of the Draft Modification Report Representations rejecting the Proposal have been received from the Association of Electricity Producers (AEP), Amerada Hess Gas Limited (Amerada), British Gas Trading (BGT), National Power Plc (NP), Quantum Gas Management Plc (Quantum), BP Amoco (BPA), TXU Europe Energy Trading Limited (TXU), PowerGen UK Plc (PowerGen) Scottish Power UK Plc (SP), Elf Gas and Power Limited (Elf) and Shell Gas Direct Limited (Shell).

Representations supporting the Proposal have been received from Aquilla Energy Limited (Aquilla), Alliance Gas Limited (Alliance), Enron Europe Limited (Enron) and Yorkshire Energy Limited (YE).

4.11.3   Concern over implementation timetable.

BGT "*raised concerns that it would not be the most appropriate use of resources to develop and implement a tolerance service for a four month period, assuming that a physical tolerance or linepack service would be in place on October 1 2000.*" Similar concerns were expressed by TXU, BPA, NP, AEP, PowerGen, SP, Shell and Amerada.

BPA "*supports the introduction of a linepack service and the associated reduction in shipper tolerances to zero*" but does not support "*the introduction of an interim tolerance service solution on 1 June 2000*". AEP, NP and Amerada have also made similar comments.

YE "*feel that the service should commence from 1 June 2000 and should not be over ridden by any further developments i.e. a linepack service in October 2000.*"

TXU "*understand that the same platform could be used to sell linepack services.*"

Transco Response:

The industry has already developed a service that will better facilitate the Relevant Objectives.

The industry have yet to define an acceptable format of a "Linepack service" and the timetable for the introduction of such a service is dependant on this definition although Transco believe that many of the concepts incorporated in the tolerance service are likely to provide fundamental elements of the "linepack" services. Therefore, Transco considers that the Tolerance Service should be introduced on the 1st June 2000. Implementation will facilitate unbundling of this element of service whilst providing important information about the value that Shippers place on flexibility.

4.11.4   Number of Auction Bids per Shipper.

BGT raised concerns over the number of "live" bids which each Shipper can place in each auction round.

Transco response:

Shippers will be able to place 20 "live" bids per tolerance type, per tolerance auction round, per month/day. As the auction rounds are separate for both Under and Over this effectively means that Shippers are able to place 40 bids per month/day.

4.11.5   Removal of the Energy Balancing Incentives Cap and Collar.

BGT have expressed concern over the reduction in Transco's incentives to avoid inferior performance when the annual collar is breached. They suggest that a "*remedy would be to remove the annual cap completely so that Transco's only limit on exposure would be the daily incentive amounts.*" BGT continue by suggesting that, to "*partially*" counter the increase in exposure, the daily incentive levels could be reduced.

Alliance is supportive of the removal of the Monthly Cap and Collar but suggest "*that Transco's upside and downside should be netted off prior to recovering or paying out any funds to the industry.*"

Transco's response:

The proposed legal text for removing the monthly cap and collar applied to Transco's Energy Balancing incentives requires Transco to continue to make payments to Shippers after the collar has been breached. Transco then recover this excess amount at the end of the Gas Year.

Netting off the upside and downside of the incentive would involve a change to the fundamental structure of the incentive mechanism agreed by the industry in October 1999. This is outside the Terms of Reference of this Modification Proposal although Transco would welcome a review of the Energy Balancing incentive to ensure it is appropriately aligned.

Transco considers that removal of the annual cap/collar and replacing them with daily figures is also outside the Terms of Reference of this Modification Proposal.

4.11.6   Methodology for recovery of interest due on over payments in relation to the Energy Balancing incentives.

BGT have "*some concerns regarding the methodology by which Transco would recover interest due.*" and express a preference "*for Transco to calculate interest that would be due on a daily basis*". TXU "*believe that calculating interest daily would offer a much better solution*".

Transco's response:

Transco proposed the simplified methodology as a pragmatic approach to a complex calculation. However, in the light of Shippers Representations Transco will now calculate the interest on a daily basis and the legal text in support of this proposal has been amended accordingly.

4.11.7   Timing of the removal of monthly Energy Balancing incentive Caps and Collars.

BGT "*does not understand the reasons for delaying implementation of this element of the proposal until June 1*".

Transco's response:

To maintain a consistent implementation date for this Modification Proposal Transco consider it appropriate to remove the Energy Balancing Incentives monthly Caps and Collars at the same time as introducing the rest of the changes within this Proposal.

4.11.8   Tolerance Quantities.

BGT expressed concern over the term "number of Shippers" used in the Transco's opinion section of this report to describe the views expressed in reference to a reduction in tolerance levels. BGT contend "*that the **majority** of shippers were opposed to this suggestion*" and that the "*Multiplication factor referred to in the fourth paragraph of this section should be embodied in the Network*

Code."

Alliance support retention of current tolerance levels and the method proposed by Transco to determine the quantities of tolerance to be made available.

Enron "*oppose any reduction in the aggregate volumes of tolerance to be made available by Transco*."

PowerGen "*believe the quantities made available in the auctions should be significantly reduced from their current levels (say by two-thirds) so as to both increase balancing incentives and counter the effect of increased "usability".* "

Elf note that Shippers are "*more likely to be use the tolerance once purchased*."

Transco's response:

The level of tolerances is now the subject of a separate Network Code Modification Proposal (0381) which has been given Urgent status by Ofgem with a timetable concurrent with this Modification Proposal.

Transco consider that tolerances quantities released via the new tolerance service auctions should broadly reflect those levels currently provided pending further detailed analysis of the benefit or otherwise, to the industry as a whole, of any changes.

The multiplication factor referred to in the BGT representation has been added to the legal text supporting this Proposal.

4.11.9   Tolerance release.

Aquilla has requested that Transco does "*not restrict the amounts released before the day*" when the monthly tolerance for that day has not sold out.

Alliance does "*not believe that a second round in the long term sale is inappropriate if the first round volume does not clear*".

Transco's response:

The mechanism for determining the quantity of tolerance to be released day ahead does not restrict the amounts released before the day where the long term auction does not sell out. On the contrary the calculation takes the forecast demand for the relevant Gas Day and multiples it by the % for the month concerned as displayed in the Ten Tear Statement (detailed in the Detailed Business Rules for

months June 2000 to September 2000 inclusive). The amount sold in the long term auction for that month is then deducted from this resultant quantity. The effect is that if a month does not sell out in the long term auction the likelihood is that more tolerance will be available in the day ahead auction.

Suspension of subsequent rounds in the long term auction for months which did not sell out in the previous round was discussed within the Development Workgroup. It was agreed within the workgroup that, due to the provision of a zero reserve price, if, a particular month did not sell out, then it would signal that there was no demand for the product at any price and therefore, there was little point in offering this product in any subsequent rounds.

4.11.10 Information release.

Alliance request that the "*maximum amount of information*" be released following the auctions, which "*should include number of successful shippers, number of successful bids, volumes allocated, highest, lowest and weighted average prices*."

Transco's response:

Transco has already undertaken to provide details on number of successful Shippers, aggregate quantities allocated, highest, lowest and weighted average prices. It is Transco's intension that sufficient information will be made available so that an informed assessment of the performance of the tolerance service can be made.

4.11.11 Auction revenue.

Alliance, Yorkshire and TXU are supportive of the principle of apportioning the auction revenue on the basis of "*good balancing*" and do not agree that auction revenues should be considered to be "*transportation revenue*". Alliance also consider that Ofgem "*has significantly understated the revenue position*". YE also supports the good balancer principle and is, therefore, disappointed by the method of revenue distribution and "*fail to see the justification of incorporating energy balancing charges within Transco's price control.*"

AEP "*support the revenue from any tolerance service being regarded as Transportation Revenue*". Aquila also hold this view.

Enron do not support recovery through 'k' and prefer "*that revenues from sales of tolerance are received by "balancing neutrality".*"

Transco's response:

Transco has reflected the views of Ofgem on this issue in section 1.1.3.10 of this Report. Transco notes that several Shippers have indicated that the Proposal made in the Development Group warrents further consideration in the broader context of Neutrality apportionment. Transco anticipates that this will be considered in the next phase of RGTA.

4.11.12 Requirement for hoarding restrictions.

Alliance "*still believe that there is a requirement for hoarding prevention measures to be implemented*", and find "*it difficult to understand why hoarding restrictions would not be applicable in this case when a 20% cap is being maintained in the forthcoming Rough and Hornsea auctions.*" Aquila also support "*a limit to the amount of tolerance any one company can purchase.*"

BGT "*agrees with the Ofgem view that no hording restrictions will apply*".

Transco's response:

Transco has reflected the views of Ofgem on this issue in section 1.1.3.9 of this Report. Transco will provide extensive information to Ofgem so it can monitor the purchase and utilisation of tolerance service should this Proposal be implemented.

4.11.13 Costs benefit analysis.

Amerada is concerned that "*the cost of implementing such a regime could well amount to more than the value of the service.*"

Quantum request that a "*detailed economic analysis is undertaken to determine whether RGTA1 has been a success*" "*Before embarking on further fundamental change*".

Alliance "*have estimated that the revenue for the period of June-September alone would be in the region of £3-4 million on the basis of the average summer SAP/SMP differentials and the Transco published tolerance figures.*"

Transco's response:

One of the drivers behind the provision of the revised tolerance regime is the facilitation of price discovery for Shipper balancing tolerances. Historically, Shipper balancing tolerances have been a bundled service within the Transportation Charges and, therefore, no

separate value has been determined for this service.

It is, however, possible to estimate the likely value of the service and Alliance appears to have taken a logical approach to establishing this value. Given that any valuation of the service is, at this stage, only an estimate based on the likely costs to be avoided by holding a tolerance level and, that the systems which are to be provided to support the tolerance auctions are also envisaged to facilitate "linepack" services once these have been developed and agreed by the industry, Transco considers that the costs incurred in providing the systems to support the tolerance auctions and trade registration are outweighed by the potential advantages.

4.11.14   <u>Transco provision of risk management services.</u>

PowerGen is "*uncomfortable with the monopoly transporter providing risk management services (i.e. providing options to buy gas at SAP rather than SMP), which may 'compete' with the OCM, further reducing liquidity in that market.*"

Transco's response:

Shippers not only use tolerance levels to protect themselves against cashout exposure due to unforeseen supply/demand fluctuations within day, but also as a tool to assist in limiting cashout exposure resulting from after the day trading

The quantities to be released within the tolerance auctions is proposed to be broadly equivalent to existing tolerance levels and as such presents no greater provision for risk management than is currently available.

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

Transco is unaware of any such requirement.

4.13   **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:**

Transco is unaware of any such requirement.

4.14 **Programme of works required as a consequence of implementing the Modification Proposal:**

a. Finalise design requirements based on agreed Business Rules,

b. Evaluate systems changes within Transco and Shippers systems,

c. Design and build systems,

d. Test revised systems internally within Transco and Shippers,

e. Test linkages between systems,

f. Implement training programmes within Transco and Shippers,

g. Amend systems to reflect observations during training and testing,

h. Retest systems,

i. Implement changes.

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

Begin building systems December 1999.
Systems tests complete by mid April 2000.
Systems implementation by mid May 2000.

The attached Business Rules V2.1 (Appendix 3) provide more detail about the implementation time-scales.

4.16 **Recommendation concerning the implementation of the Modification Proposal:**

Transco recommends that these proposals are implemented in order that the new tolerance services are introduced with effect from 1st June 2000.

4.17 **Text :**

It is proposed that the Network Code be modified as provided in Appendix Two of this document with the auction requirements taking effect from 15th May 2000 when the bidding windows for the first long term auction round will be opened and the revised tolerance regime itself taking effect on 1st June 2000.

4.18 **Restrictive Trade and Practices Act:**

If implemented this Proposal will constitute an amendment to the Network

Code. Accordingly the proposal is subject to the suspension clause set out in the attached Annex.

4.20   **Transco's Proposal:**

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Director General in accordance with this report.

<u>Signed for and on behalf of Transco.</u>

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 **0313**, version **1.0** dated 5th August 1999) be made as a Modification to the Network Code conditional upon the matters specified in section 5.18 of this report.

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

Signature:

Date:

Director Trading Arrangements

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.

1.1   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 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.

i)

Appendix 1 Tolerance Availabilities by Month

Month	SNSD (GWh) 1999/2000	Monthly Availability Percentage	x factor	33% Availability (GWh)
October	2,617	2.2	1.0	28.5
November	3,391	2.0	1.0	33.6
December	3,848	1.9	1.0	35.6
January	4,198	1.8	1.0	38.8
February	4,150	1.9	1.0	38.3
March	3,772	2.0	1.0	36.1
April	3,031	2.1	1.0	31.0
May	2,396	2.3	1.0	26.9
June	1,934	2.5	1.0	24.3
July	1,664	2.7	1.0	22.5
August	1,686	2.7	1.0	22.8
September	2,071	2.5	1.0	26.0

These SNSDs are taken directly from Table 2.2.1a in "Gas Transportation Charges from 1st October 1999"

This table gives the long term tolerance availabilities in each auction round assuming that there will be two rounds of 33% of the total tolerance available, making 66% in total. The day ahead auction would therefore, on an "average Gas Day", make the remaining 34% available

Values for October to March are included to illustrate the availabilities which would have applied if the regime had commenced on the 1st October 1999

Appendix – 2

SECTION C: NOMINATIONS
Delete paragraph 5.1.4.(v)

SECTION D: OPERATIONAL BALANCING, TRADING ARRANGEMENTS AND ENERGY BALANCING

Delete text at paragraph 3.1.5(c) and insert text to read as follows:
The "**Annual Maximum Incentive Amount**" is, in respect of the Sell Incentive Arrangement and the Buy Incentive Arrangement:

for superior performance, £2,000,000 (being a positive amount);

for inferior performance, £2,000,000 (being a positive amount); and".

Add new paragraph 3.1.5(d) to read as follows:
"in relation to any Gas Year the "**Incentive Interest Trigger Day**" is, in relation to superior and inferior performance respectively, the Day on which the aggregate Daily Incentive Amounts for all Days in the Gas Year up to and including such Day first exceed the Annual Maximum Incentive Amount.".

5   Delete paragraph 3.2.2(b).

Rename paragraph 3.3 'Aggregate Annual Amount' and delete text at paragraphs 3.3.1 and 3.3.2 and insert text to read as follows:
"For any Gas Year the "**Aggregate Annual Amount**" :

in relation to superior performance, is the sum of:

the aggregate Daily Incentive Amounts under the Buy Incentive Arrangement for all Days in the Gas Year for which performance was superior; and

the aggregate Daily Incentive Amounts under the Sell Incentive Arrangement for all Days in the Gas Year for which performance was superior;

in relation to inferior performance, is the sum of:

the aggregate Daily Incentive Amounts under the Buy Incentive Arrangement for all Days in the Gas Year for which performance was inferior; and

the aggregate Daily Incentive Amounts under the Sell Incentive Arrangement for all Days in the Gas Year for which performance was inferior.".

Rename paragraph 3.4 'Daily Incentive Amount'.

Amend paragraph 3.4.2(b) to read as follows:

"…., the "**User Daily Incentive Amount**" is the Daily Incentive Amount multiplied by the User Proportion for that Day;".

Renumber existing paragraph 3.5 as 3.7 and insert text to read as follows at paragraphs 3.5 and 3.6:

"3.5   **Annual Incentive Adjustment**

3.5.1   The provisions of this paragraph 3.5 apply in respect the Buy Incentive Arrangement and the Sell Arrangement, and shall be given effect in respect of each of them separately, in relation to any Gas Year in respect of which the Aggregate Annual Amount exceeds the Annual Maximum Incentive Amount (but not otherwise).

3.5.2   For the purposes of this paragraph 3:

the "**User Annual Maximum Incentive Amount**" is, in relation to a Gas Year, the Annual Maximum Incentive Amount multiplied by the User Annual Proportion;

for each relevant User, for each Gas Year in respect of which this paragraph 3.5 applies, the "**User Annual Incentive Adjustment Amount**" is the amount by which the aggregate of the User Daily Incentive Amounts exceeds the User Annual Maximum Incentive Amount; and

the "**User Annual Proportion**" for a User in relation to a Gas Year is the sum of the relevant UDQIs and relevant UDQOs for that User for each Day in the Gas Year, divided by the sum for all relevant Users of their relevant UDQIs and relevant UDQOs for each Day in the Gas Year.

3.5.3   In respect of each Gas Year for which performance was superior, Transco shall pay each User the User Annual Incentive Adjustment Amount.

3.5.4   In respect of each Gas Year for which performance was inferior, each User shall pay Transco the User Annual Incentive Adjustment Amount.

3.6   **Incentive Interest Amount**

3.6.1   The provisions of this paragraph 3.6 apply in respect any Gas Year during which there is an Incentive Interest Trigger Day and apply in respect of both aggregate superior and inferior performance under the Buy Incentive Arrangement and the Sell Incentive Arrangement and shall be given effect in respect of each of superior and inferior performance separately.

3.6.2   For the purposes of this paragraph 3:

the "**Daily Incentive Interest Amount**" for a Day is the amount calculated as:

$$(CB * IR) / GYD$$

6   where:

7   CB   is the closing balance for the Day;

8   IR   is the base rate of Barclays Bank plc applying on the Day;

9   GYD   is the number of Day in the Gas Year;

10 (b) the "**closing balance**" for a Day in the Gas Year following the Incentive Interest Trigger Day, is the amount of the opening balance, plus the aggregate amount (if any) of Daily Incentive Amounts for the Day for which performance under the Buy Incentive Arrangement and the Sell Incentive Arrangement was superior or (as the case may be) inferior;

11 (c) the "**opening balance**" for a Day in the Gas Year following the Incentive Interest Trigger Day is:

in the case of the Day following the Incentive Interest Trigger Day, the amount by which the aggregate Daily Incentive Amounts for all Days in the Gas Year up to and including the Incentive Interest Trigger Day exceeds the Annual Maximum Incentive Amount

for each subsequent Day in the Gas Year, the closing excess balance for the Preceding Day;

12 (d) in respect of a Gas Year the "**Annual Incentive Interest Amount**" is the sum of the Daily Incentive Interest Amount for each remaining Day in the Gas Year following the Incentive Interest Day; and

13 (e) for each relevant User, for each Gas Year in respect of which this paragraph 3.6 applies, the "**User Annual Incentive Interest Amount**" is the Annual Incentive Interest Amount multiplied by the User Annual Incentive Proportion; and

14 (d) the "**User Annual Interest Proportion**" for a User in relation to a Gas Year is the sum of the relevant UDQIs and relevant UDQOs for that User for each Day following the Incentive Interest Trigger Day in the Gas Year, divided by the sum for all relevant Users of their relevant UDQIs and relevant UDQOs for each Day in the Gas Year following the Incentive Interest Trigger Day.

3.6.3   In respect of a Gas Year for which performance was superior, Transco will pay to each User the User Annual Incentive Interest Amount.

3.6.4   In respect of a Gas Year for which performance was inferior, each relevant User will pay to Transco the User Annual Incentive Interest Amount.".

Amend renumbered paragraph 3.7 to read as follows:

"Amounts payable by way of User Daily Incentive Amount, User Annual Incentive Interest Amount and User Annual Incentive Adjustment Amount…."

SECTION E: DAILY QUANTITIES, IMBALANCE AND RECONCILIATION

Rename Section E 'DAILY QUANTITIES, IMBALANCE, RECONCILIATION AND IMBALANCE TOLERANCES'.

Add new paragraphs 9 and 10 to read as follows:

"9.   **IMBALANCE TOLERANCES**

9.1   **Introduction**

9.1.1   Users may apply for and be registered as holding an Imbalance Tolerance:

as Monthly Imbalance Tolerance pursuant to an auction under paragraph 9.3;

as Daily Imbalance Tolerance pursuant to an auction under paragraph 9.4.

9.1.2   A User may not apply for or be registered as holding an Imbalance Tolerance on any Day in an amount less than 100,000 kWh (the "**minimum imbalance tolerance**").

9.1.3   For the purposes of the Code:

"**Monthly Imbalance Tolerance**" is an Imbalance Tolerance which may be applied for and registered as held (in a given amount) by a User for each Day in a particular calendar month;

"**Daily Imbalance Tolerance**" is an Imbalance Tolerance which may be applied for and registered as held (in a given amount) by a User for a particular Day only;

9.1.4   For the purposes of the Code:

an "**Imbalance Tolerance**" is, in relation to a User and a Day, a tolerance (expressed in kWh) determined in accordance with this paragraph 9;

a User's "**Registered**" Imbalance Tolerance on any Day is the Imbalance Tolerance which the User is registered (in accordance with this paragraph 9) as holding on such Day;

a User's "**Available**" Imbalance Tolerance on any Day is the Imbalance Tolerance which the User holds on such Day after taking account of any Imbalance Tolerance Transfer, in accordance with paragraph 10;

a "**Tolerance Charge**" is a charge payable by reason of the User holding an Imbalance Tolerance (without prejudice to paragraph 10.5.2(c), pursuant to the allocation of Monthly Imbalance Tolerance or Daily Imbalance Tolerance in respect of bids submitted by the User in accordance with this paragraph 9); and

an Imbalance Tolerance may be either:

a surplus Imbalance Tolerance, in which case it will be used for the purposes of calculating Imbalance Charges payable where the relevant User's Daily Imbalance is positive, and not otherwise; or

a deficit Imbalance Tolerance, in which case it will be used for the purposes of calculating Imbalance Charges payable where the relevant User's Daily Imbalance is negative, and not otherwise.

9.1.5   For the avoidance of doubt:

in respect of any Day, a User may hold both a surplus Imbalance Tolerance and a deficit Imbalance Tolerance (but need not hold either or both);

where a User ceases to be a User in accordance with Section V4.3, the Imbalance Tolerance which the User was registered as holding shall (with effect from the latest time by which a tolerance transferee election might be made) cease to be treated as held by any User, save to the extent to which any other User elects to be registered as holding such Imbalance Tolerance pursuant to paragraph 10.5.1(c) (a "**transferee tolerance election**") or paragraph 10.5.3 applies.

9.2   **Imbalance Tolerance Availability**

9.2.1   Transco will calculate, in accordance with this paragraph 9.2, for each calendar month in the Gas Year, the amount ("**Aggregate Monthly Imbalance Tolerance**") (in kWh) available to be held as Monthly Imbalance Tolerance and notify Users by not later than 31 July in the Preceding Year.

9.2.2   For each calendar month in the Gas Year:

the "**Aggregate Monthly Imbalance Tolerance**" is a quantity of gas equivalent to:

$$TIT \ * \ AMTF$$

where:
TIT   is the Total Imbalance Tolerance; and
AMTF   is the Available Monthly Tolerance Factor;

15   (b) the "Total Imbalance Tolerance" is:

$$SMTF \ * \ SND$$

where:
SMTF   is the System Monthly Tolerance Factor; and
SND   is System Normal Demand
provided that in respect of any calendar month the Total Imbalance Tolerance shall be not less than:

$$(A \ + \ B \ + C) \ * \ RF$$

where in respect of the relevant month:
A   is 2.0% of System Normal Demand;
             B   is 3.0% of the forecast of the quantities of gas to be offtaken at VLDMC Supply Point Components;
             C   is 8% of the forecast of the quantities of gas to be offtaken at DM Supply Point Components other than VLDMC Supply Point Components; and
             RF   is the Reduction Factor
in the case of A, B and C, as set out in the Transportation Statement;

16   (c) the "**Available Monthly Tolerance Factor**" and the "**System Monthly Tolerance Factor**" are the factors so named in respect of each calendar month set out, together with the Total Imbalance Tolerance, in the Transportation Statement;

17   (d) for the purposes of paragraph (b) the "**Reduction Factor**" is zero decimal seven five (0.75).

9.2.3   For the avoidance of doubt in respect of any calendar month the amount of surplus Aggregate Monthly Imbalance Tolerance and deficit Aggregate Monthly Imbalance Tolerance shall always be equal.

9.3   **Auction of the Monthly Imbalance Tolerance Amount**

9.3.1   Transco will invite applications for Monthly Imbalance Tolerance for the calendar months:

October to March (inclusive) in the Gas Year, by not later than 7 September in the Preceding Year;

April to September (inclusive) in the Gas Year, by not later than 7 March in such Gas Year.

9.3.2   Transco's invitations under paragraph 9.3.1 shall specify the two dates ("**invitation dates**", each of which shall be a Business Day) on which applications pursuant to each such invitation may be made, the last of which such dates shall be not later than the respective dates referred to in such paragraph; and the period between each such invitation date shall be not less than one Business Day.

9.3.3   Subject to paragraph 9.3.14, in respect of each invitation date Users may apply for Monthly Imbalance Tolerance in respect of a relevant calendar month in the Gas Year in accordance with this paragraph 9.3.

9.3.4   Where there is more than one invitation date in respect of any calendar month in the Gas Year the amount of Monthly Imbalance Tolerance which Transco may make available on each such invitation date shall be equal.

9.3.5   An application (a "**monthly tolerance bid**") for Monthly Imbalance Tolerance pursuant to this paragraph 9.3:

shall specify:

the identity of the User;

the calendar month in the Gas Year for which Monthly Imbalance Tolerance is applied for;

the amount, in multiples of 100,000 kWh, of Monthly Imbalance Tolerance applied for;

whether the monthly tolerance bid is for surplus or deficit Monthly Imbalance Tolerance;

the amount (the "**bid price**", which shall not be less than zero) in pence/kWh (expressed to four decimal places) which the User is willing to pay by way of Tolerance Charge for the Monthly Imbalance Tolerance applied for;

 may not be submitted:

in respect of the first invitation date in March or September, before 06:00 on the first Day of such calendar month;

in respect of any later invitation date in such month, before 06:00 hours on the Business Day next following the previous invitation date; and

after 17:00 hours on an invitation date;

may be amended or withdrawn until, but not after, 17:00 hours on the invitation date.

9.3.6   In respect of each invitation date:

a User may submit up to but not more than 20 monthly tolerance bids (for each of surplus and deficit Monthly Imbalance Tolerance) for a relevant calendar month; and

a User may not submit more than one bid for surplus or deficit Imbalance Tolerance at the same bid price in respect of the same calendar month

(and a bid submitted and subsequently withdrawn will not be considered for the purposes of this paragraph 9.3.6).

9.3.7   Transco will reject a monthly tolerance bid where the amount of Monthly Imbalance Tolerance applied for exceeds the maximum amount of Monthly Imbalance Tolerance available to be applied for on such invitation date, or where any requirement of paragraph 9.3.5 is not complied with and may reject such an application in accordance with Section V3.

9.3.8   For each calendar month in the Gas Year, both surplus and deficit Monthly Imbalance Tolerance will be allocated pursuant to monthly tolerance bids as follows (and the provisions of this paragraph 9.3.8 and paragraphs 9.3.9 shall apply separately and independently as regards bids for surplus Monthly Imbalance Tolerance and deficit Monthly Imbalance Tolerance):

all monthly tolerance bids (excluding any rejected pursuant to paragraph 9.3.7) will be ranked in order of price (the highest priced ranked first);

Monthly Imbalance Tolerance will be allocated in respect of each bid, in descending order of price starting with the highest priced, subject to paragraph (c), in the amount applied for, until the amount of Monthly Imbalance Tolerance in aggregate for which bids have been accepted for is equal the Available Monthly Imbalance Tolerance;

subject to paragraph (d), where the amount of Monthly Imbalance Tolerance applied for exceeds the amount (the **"remaining unallocated amount"**) of the Available Monthly Imbalance Tolerance remaining unallocated after allocation to higher priced bids, the User will be allocated Monthly Imbalance Tolerance in an amount equal to:

where the remaining unallocated amount is less than the minimum imbalance tolerance, the minimum imbalance tolerance;

where the remaining unallocated amount is greater than the minimum imbalance tolerance, the next following multiple of the minimum imbalance tolerance;

where each of two or more bids ("**equal priced bids**") specifies the same bid price, and the amount of Monthly Imbalance Tolerance applied for in aggregate exceeds the remaining unallocated amount, each User submitting an equal price bid will be allocated Monthly Imbalance Tolerance pro rata to the amounts applied for in each such bid (the "**remaining eligible amount**")provided that:

where the remaining eligible amount is less than the minimum imbalance tolerance, the amount allocated will be equal to the minimum imbalance tolerance;

where the remaining eligible amount is greater than the minimum imbalance tolerance, the amount allocated will be equal to the next following multiple of the minimum imbalance tolerance.

9.3.9 Transco will accept bids in respect of which Monthly Imbalance Tolerance is allocated in accordance with paragraph 9.3.8, and each User whose bid is so accepted will be registered as holding Monthly Imbalance Tolerance (in the amount so allocated) for the relevant calendar month in the Gas Year.

9.3.10 Transco will, not later than 06:00 hours on the Business Day following each invitation date, inform each User of those of its monthly tolerance bids which have been accepted and the amount of surplus and/or deficit Monthly Imbalance Tolerance which it is registered as holding for a calendar month in the Gas Year pursuant to each such accepted bid.

9.3.11 Each User who applies for Monthly Imbalance Tolerance shall tender, in respect of each monthly tolerance bid made, a bid price (in accordance with paragraph 9.3.4(a)(v)), and agrees by making such application to pay by way of Tolerance Charges the bid price so tendered in respect of Monthly Imbalance Tolerance allocated in accordance with this paragraph 9.3 pursuant to such monthly tolerance bid.

9.3.12   For the purposes of this paragraph 9.3, the "**Available Monthly Imbalance Tolerance**" in respect of a calendar month is the maximum amount of Monthly Imbalance Tolerance which will be allocated following submission of monthly tolerance bids on an invitation date; and the aggregate of the Available Monthly Imbalance Tolerance in relation to the invitation dates in respect of a calendar month shall be equal to the Aggregate Monthly Imbalance Tolerance.

9.3.13   As soon as reasonably practicable after the time referred to in paragraph 9.3.10, Transco will notify all Users of:

the number of Users who submitted an application for surplus and/or deficit Monthly Imbalance Tolerance and the number of Users who were allocated surplus and/or deficit Monthly Imbalance Tolerance;

the Available Monthly Imbalance Tolerance and the aggregate amount of both surplus and deficit Monthly Imbalance Tolerance allocated to Users;

the highest and lowest bid price in respect of a bid for which surplus and/or deficit Monthly Imbalance Tolerance was allocated; and

the weighted average price in respect of bids for which surplus and/or deficit Monthly Imbalance Tolerance was allocated (in pence/kWh) calculated as:

$$\frac{\sum_{i=1}^{n} Q_i * P_i}{\sum_{i=1}^{n} Q_i}$$

where (separately in respect of surplus and deficit bids):

n   is the number of successful bids;

Q   is the amount of Monthly Imbalance Tolerance allocated to each successful bid;

P   is the bid price of each successful bid.

9.3.14   In the event that following submission of monthly tolerance bids on any invitation date the amount of surplus or deficit Monthly Imbalance Tolerance allocated to bids in aggregate is less than the Available Monthly Imbalance Tolerance available on such date Transco shall notify Users accordingly and Users may not apply for surplus or (as the case may be) deficit Monthly Imbalance Tolerance for the relevant month on any subsequent invitation date.

9.4   **Daily Imbalance Tolerance Amount**

9.4.1   Users may apply for Daily Imbalance Tolerance for a Day in accordance with this paragraph 9.4.

9.4.2   An application (a "**daily tolerance bid**") for Daily Imbalance Tolerance pursuant to this paragraph 9.4:

shall specify:

the identity of the User;

the Day for which Daily Imbalance Tolerance is applied for;

the amount, in multiples of 100,000 kWh/Day, of Daily Imbalance Tolerance applied for;

whether the daily tolerance bid is for surplus or deficit Daily Imbalance Tolerance;

the amount (the "**bid price**", which shall not be less than zero) in pence/kWh (expressed to four decimal places) which the User is willing to pay by way of Tolerance Charge for the Daily Imbalance Tolerance applied for;

may be submitted at any time from the 7th Day before the Gas Flow Day until 15:00 hours on the Preceding Day;

may be amended or withdrawn until, but not after, 15:00 hours on the Preceding Day; and

may not, where submitted on or after 14:00 hours on the Preceding Day, be for an amount of Daily Imbalance Tolerance which exceeds the Available Daily Imbalance Tolerance.

9.4.3   A User may submit up to but not more than 20 daily tolerance bids (for each of surplus and deficit Daily Imbalance Tolerance for a Day (and a bid submitted and subsequently withdrawn will not be considered for the purposes of this paragraph 9.4.3).

9.4.4   Transco will reject a daily tolerance bid where any requirement of paragraph 9.4.2 is not complied with and may reject such an application in accordance with Section V3.

9.4.5   For each calendar month in the Gas Year, both surplus and deficit Daily Imbalance Tolerance will be allocated pursuant to daily tolerance bids as follows (and the provisions of this paragraph 9.4.5 and paragraph 9.4.6 shall apply separately and independently as regards bids for surplus Daily Imbalance Tolerance and deficit Daily Imbalance Tolerance):

all daily tolerance bids (excluding any rejected pursuant to paragraph 9.4.4) will be ranked in order of price (the highest priced ranked first);

Daily Imbalance Tolerance will be allocated in respect of each bid, in descending order of price starting with the highest priced, subject to paragraph (c), in the amount applied for, until the amount of Daily Imbalance Tolerance in aggregate for which bids have been accepted for is equal to the Available Daily Imbalance Tolerance;

where the amount of Daily Imbalance Tolerance applied for under a daily tolerance bid submitted prior to 14:00 hours on the Preceding Day exceeds the Available Daily Imbalance Tolerance, the bid will be deemed (for the purposes of this paragraph 9.4.5) to have made for an amount equal to the Available Daily Imbalance Tolerance;

subject to paragraph (e), where the amount of Daily Imbalance Tolerance applied for exceeds the amount (the **"remaining unallocated amount"**) of the Available Daily Imbalance Tolerance remaining unallocated after allocation to higher priced bids, the User will be allocated Daily Imbalance Tolerance in an amount equal to:

where the remaining unallocated amount is less than the minimum imbalance tolerance, the minimum imbalance tolerance;

where the remaining unallocated amount is greater than the minimum imbalance tolerance, the next following multiple of the minimum imbalance tolerance;

where each of two or more bids ("**equal priced bids**") specifies the same bid price, and the amount of Daily Imbalance Tolerance applied for in aggregate exceeds the remaining unallocated amount, each User submitting an equal price bid will be allocated Daily Imbalance Tolerance pro rata to the amounts applied for in each such bid (the **"remaining eligible amount"**) provided that:

where the remaining eligible amount is less than the minimum imbalance tolerance, the amount allocated will be equal to the minimum imbalance tolerance;

where the remaining eligible amount is greater than the minimum imbalance tolerance, the amount allocated will be equal to the next following multiple of the minimum imbalance tolerance.

9.4.6   Transco will accept bids in respect of which Daily Imbalance Tolerance is allocated in accordance with paragraph 9.4.5, and each User whose bid is so accepted will be registered as holding Daily Imbalance Tolerance (in the amount so allocated) for the relevant Day.

9.4.7   Transco will, not later than 15:30 hours on the Preceding Day, inform each User of those of its daily tolerance bids which have been accepted and the amount of surplus and/or deficit Daily Imbalance Tolerance which it is registered as holding pursuant to each such accepted bid.

9.4.8   For the purposes of this paragraph 9.4, the "**Available Daily Imbalance Tolerance**" in respect of any Day is the greater of zero and an amount calculated as:

$$(SMTF * FTSD) - AMIT$$

where:

SMTF   is the System Monthly Tolerance Factor for the calendar month in which such Day falls;

FTSD   is the Forecast Total System Demand at 13:00 hours on the Preceding Day; and

AMIT   is the aggregate amount of Monthly Imbalance Tolerance allocated for each Day in the calendar month in which such Day falls pursuant to paragraph 9.3

and Transco will not later than 14:00 hours on the Preceding Day notify to Users the amount (if any) of Available Daily Imbalance Tolerance for the Gas Flow Day.

9.4.9   As soon as reasonably practicable after the time referred to in paragraph 9.4.7, Transco will notify all Users of:

the number of Users who submitted an application for surplus and/or deficit Daily Imbalance Tolerance and the number of Users who were allocated surplus and/or deficit Daily Imbalance Tolerance;

the Available Daily Imbalance Tolerance and the aggregate amount of both surplus and deficit Daily Imbalance Tolerance allocated to Users;

the highest and lowest bid price in respect of a bid for which Daily Imbalance Tolerance was allocated; and

the weighted average price in respect of bids for which surplus and/or deficit Daily Imbalance Tolerance was allocated (in pence/kWh) calculated as:

$$\frac{\sum_{i=1}^{n} Q_i * P_i}{\sum_{i=1}^{n} Q_i}$$

where (separately for surplus and deficit bids):

n is the number of successful bids;

Q is the amount of Daily Imbalance Tolerance allocated to each successful bid;

P is the bid price for each successful bid.

9.4.10   Tolerance Charges will be invoiced and payable in accordance with Section S.

10   **IMBALANCE TOLERANCE TRANSFER**

10.1   **Basis of transfer**

10.1.1   A User (the "**Transferor User**") may transfer all or part of its Available Imbalance Tolerance to another User (the "**Transferee User**") subject to and in accordance with this paragraph 10.

10.1.2   For the purposes of the Code an "**Imbalance Tolerance Transfer**" is a transfer of Imbalance Tolerance in accordance with this paragraph 10.

10.1.3   An Imbalance Tolerance Transfer may be for any Day or consecutive number of Days.

10.1.4   In respect of an Imbalance Tolerance Transfer or proposed Imbalance Tolerance Transfer:

the "**Transferred Imbalance Tolerance**" is the Imbalance Tolerance (whether surplus or deficit) which is (or is to be) transferred; and

the "**Tolerance Transfer Period**" is the Day or Days (in accordance with paragraph 10.1.3) for which the Transferred Imbalance Tolerance is (or is to be) transferred.

10.2   **Procedure**

10.2.1   Where a User proposes to make an Imbalance Tolerance Transfer, the Transferor User must notify the Imbalance Tolerance Transfer to Transco specifying:

the identity of the Transferor User and the Transferee User;

the amount of the Transferred Imbalance Tolerance;

whether the Transferred Imbalance Tolerance is surplus or deficit; and

the Tolerance Transfer Period.

10.2.2   Without prejudice to paragraph 10.2.4, an Imbalance Tolerance Transfer will be effective if the Transferee User confirms to Transco that the details notified by the Transferor User are correct by not later than 03:35 hours on the Day on which the Tranferor User so notified Transco.

10.2.3   A proposed Imbalance Tolerance Transfer may not be notified later than 03:35 hours on the first Day of the Tolerance Transfer Period.

10.2.4   Transco may reject an Imbalance Tolerance Transfer:

where the Transferor User does not notify Transco in accordance with paragraph 10.2.1 or 10.2.3;

where the Transferee User does not notify Transco in accordance with paragraph 10.2.2.

10.2.5   Where an Imbalance Transfer is effective in accordance with this paragraph 10.2, the Transferee User shall be deemed to hold the Transferred Imbalance Tolerance with effect from the first Day of the Transfer Period.

10.3   **Effect of Imbalance Tolerance Transfer**

10.3.1   Except for the purposes of paragraph 10.3.3, and subject to paragraph 10.4, the Transferee User will be treated during the Tolerance Transfer Period as the holder of the Transferred Imbalance Tolerance.

10.3.2   A User's Available Imbalance Tolerance on a Day is its Registered Imbalance Tolerance, adjusted in respect of any Imbalance Tolerance Transfer (for which the Tolerance Transfer Period includes that Day) by adding the Transferred Imbalance Tolerance where the User was the Transferee User, and deducting the Transferred Imbalance Tolerance where the User was the Transferor User, subject to paragraph 10.5.

10.3.3   A User will remain liable for the Tolerance Charges in respect of its Registered Imbalance Tolerance irrespective of any Imbalance Tolerance Transfer.

10.4   **Imbalance Tolerance Deficit**

10.4.1   In respect of any Day where:

the sum of:

the User's Available Imbalance Tolerance at the start of such Day; and

the Transferred Imbalance Tolerance under any Imbalance Transfers for where such Day falls within the Transfer Period and in respect of which the User was the Transferee User; is less than:

the Transferred Imbalance Tolerance under any Imbalance Transfers for such Day falls within the Transfer Period and in respect of which the User was the Transferor User

(the amount of any such shortfall being referred to as the "**Imbalance Tolerance Shortfall**")then the User shall pay a charge ("**Tolerance Shortfall Charge**").

10.4.2   Where and for so long as a User holds an Imbalance Tolerance Shortfall the User will be liable to pay a Tolerance Shortfall Charge calculated as:

$$TSC = (ITS * (SMPr - SAP) * 1.1)$$

where:

TSC   is the Tolerance Shortfall Charge;

ITS   is the Imbalance Tolerance Shortfall;

SMPr   is, where the relevant Imbalance Tolerance Transfer was in respect of:

(i)   surplus Imbalance Tolerance, the System Marginal Sell Price; and

(ii)   deficit Imbalance Tolerance, the System Marginal Buy Price

for the relevant Day; and

SAP   is the System Average Price for the relevant Day

(provided that where the product of such calculation is a negative it shall be deemed to be a positive of the same value).

10.4.3   In respect of any Day in relation to which a User holds an Imbalance Tolerance Shortfall, for the purpose of Section F2.2 the User shall be deemed to have a relevant Imbalance Tolerance of zero.

10.4.4   Tolerance Shortfall Charges will be invoiced and payable in accordance with Section S.

10.5   **Effect of Termination**

10.5.1   Where during the Tolerance Transfer Period in respect of an Imbalance Tolerance Transfer the Transferor User ceases to be a User in accordance with Section V4.3:

Transco will so notify the Transferee User as soon as reasonably practicable and in any event not more than 5 Business Days after giving Termination Notice to the Transferor User;

with effect from the User Discontinuance Date the Imbalance Tolerance Transfer will lapse and the Transferee User will cease to be treated as holding the Transferred Imbalance Tolerance;

the Transferee User may elect to be registered in accordance with paragraph 10.5.2 as holding Imbalance Tolerance (in addition to any such Imbalance Tolerance held other than by virtue of the Imbalance Tolerance Transfer):

in an amount not exceeding the Transferred Imbalance Tolerance; and

for any Day or consecutive Days (before or after the date of such election, but not before the User Discontinuance Date) within the Tolerance Transfer Period.

10.5.2   Where under paragraph 10.5.1 the Transferee User elects to be registered as holding Imbalance Tolerance:

the Transferee User shall notify Transco, as soon as reasonably practicable and in any event not more than 5 Business Days after Transco's notice under paragraph 10.5.1(a), of such election, specifying the Imbalance Tolerance and the date or period in accordance with paragraphs 10.5.1(c)(i) and (ii);

the Transferee User will be registered as holding Imbalance Tolerance in the amount and for the period elected (notwithstanding any other requirement of the Code as to the prior notice required for or the period of registration);

the Transferee User will accordingly be liable for Tolerance Charges, (calculated in accordance with paragraph 10.5.4) in respect of the elected amount of Imbalance Tolerance for the elected period.

10.5.3   Where during the Transfer Period in respect of a Imbalance Tolerance Transfer the Transferee User ceases to be a User in accordance with Section V4.3:

Transco will so notify the Transferor User as soon as reasonably practicable and in any event not more than 5 Business Days after giving Termination Notice to the Transferee User;

with effect from the User Discontinuance Date, the Imbalance Tolerance Transfer will lapse and the Transferee User will cease to be treated as holding the Transferred Imbalance Tolerance which will revert to (and be treated as held by) the Transferor User.

10.5.4   Where paragraph 10.5.3 applies the Tolerance Charge to be applied in respect of the Transferred Imbalance Tolerance for the elected period will be the weighted average price (calculated in accordance with paragraph 9.3.13) in respect of bids for which surplus or (as the case may be) deficit Monthly Imbalance Tolerance was allocated in relation to the relevant calendar month.".

SECTION F: SYSTEM CLEARING, BALANCING CHARGES AND NEUTRALITY

Amend paragraph 1.3.1 to read as follows:

"….for the purposes of paragraph 3.2.2….";

Amend paragraph 1.3.2 to read as follows:

"….for the purposes of paragraph 3.2.2….";

Amend paragraph 2.2.1 to read as follows:
"The Imbalance Tolerance Quantity for a User for a Day shall be determined as the sum of:

the User's relevant Available Imbalance Tolerance (if any); and

the magnitude of the User's NDM Forecast Deviation (if any) for the Gas Flow Day in accordance with paragraph 2.2.3."

Delete text at paragraph 2.2.2 as insert text to read as follows:
"For the purposes of paragraph 2.2.1, on a Day the User's "**relevant**" Available Imbalance Tolerance" is, where the User's Daily Imbalance is,

positive, its surplus Available Imbalance Tolerance; and

negative, its deficit Available Imbalance Tolerance

for such Day.
SECTION V: GENERAL
Delete text at paragraph 3.3.2(iv) and insert text to read as follows:
"an application for an Imbalance Tolerance."