

Draft Modification Report
Rebalancing System Entry Capacity Charges with respect to Barrow and St Fergus System
Entry Points

Modification Reference Number 0459
Version 1.0

This Draft 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

It is proposed that a levy is charged to users delivering gas at Barrow entry point to reflect the dependence which Barrow gas has on St Fergus gas, which allows Barrow gas to be deemed to meet Transco's entry specification.

The revenue from the levy will be paid to St Fergus users, based on actual usage of the St Fergus system entry point (UDQI's).

The levy should be linked to the ratio of St Fergus gas to Barrow gas deemed necessary by Transco to mix in Transco's NTS at Lupton, in order to allow Barrow gas to be deemed to meet the required entry specification for Transco's pipeline system.

It is proposed that the ratio of St Fergus to Barrow gas required for mixing, be used to derive an adjusted price differential between the two entry points, for each month, using the results from the MSEC auction process. The adjustment will become an additional system entry charge for Barrow users, and will generate revenue which will be passed to St Fergus users, to offset their system entry charges.

The levy would be calculated using the following mechanism:

On days when the required volume of St Fergus mixing gas is equal to or greater than the volume flowing from Barrow, the differential between the system entry charges at Barrow and St Fergus should be zero. Therefore the following mechanism is used to make the nominal system entry charges equal.

Example 1:

MSEC April;

WAP top 50%, Barrow 0.0066 p/kWh, St Fergus 0.2623 p/kWh

hence differential = $0.2623 - 0.0066 = 0.2557$ p/kWh.

Assume actual flows:

Barrow UDQI = 500 GWh

St Fergus UDQI = 1350 GWh

And mixing ratio is 1:1 (Barrow : St Fergus)

Price differential should be zero, therefore add to Barrow price 50% of the published MSEC differential:

i.e. $0.2557/2 = 0.1279$ p/kWh

hence Barrow attracts a levy of 0.1279 p/kWh.

Applied to Barrow UDQI, 500 GWh generates £639,000 charge.

Smeared to St Fergus UDQI, 1350 GWh, provides 0.047 p/kWh payment to St Fergus users.

Example 2:

MSEC July;

WAP top 50%, Barrow 0.0066 p/kWh, St Fergus 0.2920 p/kWh

hence differential = $0.2920 - 0.0066 = 0.2854$ p/kWh

Assume actual flows:

Barrow UDQI = 100 GWh

St Fergus UDQI = 500 GWh

And mixing ratio is 1 : 3 (Barrow : St Fergus)

Price differential should be zero, therefore add to Barrow price 50% of the published MSEC differential:

i.e. $0.2854/2 = 0.1427$ p/kWh

hence Barrow attracts a levy of 0.1427 p/kWh.

Applied to Barrow UDQI, 100 GWh generates £142,700 charge.

Smeared to St Fergus UDQI, 500 GWh, provides 0.0285 p/kWh payment to St Fergus users.

On days when the requirement for St Fergus mixing gas is less than the volume flowing from Barrow, the differential should be adjusted to reflect the actual mixing ratio:

Example 3:

MSEC April;

WAP top 50%, Barrow 0.0066 p/kWh, St Fergus 0.2623 p/kWh

hence differential = $0.2623 - 0.0066 = 0.2557$ p/kWh.

Assume actual flows:

Barrow UDQI = 500 GWh

St Fergus UDQI = 1350 GWh

And mixing ratio is 2:1 (Barrow : St Fergus)

Price differential should be adjusted to reflect 2:1 mixing ratio, therefore add to Barrow price 33% of the published MSEC differential:

i.e. $0.2557/3 = 0.0852$ p/kWh

hence Barrow attracts a levy of 0.0852 p/kWh. Applied to Barrow UDQI, 500 GWh generates £426,000 charge.

Smear to St Fergus UDQI, 1350 GWh, provides 0.032 p/kWh payment to St Fergus users.

Example 4:

MSEC July;

WAP top 50%, Barrow 0.0066 p/kWh, St Fergus 0.2920 p/kWh

hence differential = $0.2920 - 0.0066 = 0.2854$ p/kWh

Assume actual flows:

Barrow UDQI = 100 GWh

St Fergus UDQI = 500 GWh

And mixing ratio is 3:1 (Barrow : St Fergus)

Price differential should be adjusted to reflect 3:1 mixing ratio, therefore add to Barrow price 25% of the published MSEC differential:

i.e. $0.2854/4 = 0.0714$ p/kWh

hence Barrow attracts a levy of 0.0714 p/kWh.

Applied to Barrow UDQI, 100 GWh generates £71,400 charge.

Smear to St Fergus UDQI, 500 GWh, provides 0.0142 p/kWh payment to

St Fergus users. The proposal that the levy is Barrow flow-related ensures that at low Barrow flows there would be a proportionately low additional charge, with low payments to St Fergus users, and vice-versa for high Barrow flows.

Options for assessing the ratio include:

Daily - Transco can assess the mixing ratio required on each day, and the levy can be applied daily on a variable basis, and included in the monthly invoicing cycle, as a charge to Barrow users and a balancing payment to St Fergus users.

Monthly - Transco can assess the mixing ratio required on each day in a month, and the weighted average taken, so that the levy can be applied on a monthly averaged basis. This levy can also be included in the monthly invoicing cycle.

Six monthly - To correspond to the current MSEC auction periods, the daily or monthly process can be applied over a six-monthly period, and the results used for the six months following.

The revenues recovered by Transco in the MSEC auction process are unaffected by this proposal.

Prices set by the MSEC auction processes are unaffected by this proposal.

2. Transco's Opinion

Transco acknowledges the differential in system entry charges that exists between Barrow and St Fergus. Separately, Transco acknowledges that gas delivered at Barrow is usually blended with gas delivered at St. Fergus for gas quality reasons. It also recognises that as a

result of this large price differential a comparison has been drawn with the gas mixing that occurs between gas delivered from the two entry points.

In Transco's view, there is no direct linkage between entry charging and gas blending, and the suggestion by the proposer to introduce a dependency on the extent of gas mixing taking place is to address a concern with relative entry capacity charges at St Fergus and Barrow. Indeed the proposer has acknowledged that its primary concern relates to the differential in charges rather than the value to Barrow Users of the mixing of gas from St. Fergus with lower quality gas from Barrow.

It is Transco's view that the issues discussed in the proposal should be separated and that the concern regarding high differential in entry capacity charges should be addressed within the context of wider discussions on NTS entry capacity auctions. Such discussions might seek to take into consideration disparities caused as a consequence of entry capacity auctions in their entirety, rather than in specific cases .

Transco would also emphasise that the blending of gas, which is a purely physical process, is undertaken to maintain the required statutory gas quality levels across the network. It is not undertaken as the proposer suggests, to allow Barrow gas to be deemed to meet Transco's system entry specification. Transco considers that it is inappropriate that this physical process is considered as a remedy for the price differentials between entry capacity charges at St. Fergus and Barrow.

Transco observes that the Modification Proposal addresses the charges for monthly firm capacity only and takes no account of holdings of monthly interruptible capacity and daily firm and interruptible capacity. The proposal to introduce a variable daily adjustment to entry capacity charges at St. Fergus and Barrow may affect shippers' valuations of all capacity products and add additional uncertainty to the capacity charges they are likely to face. Further to this, the knowledge that capacity holders at St Fergus are likely to receive a rebate, the level of which will depend on the mixing ratio, may further influence prices bid for entry capacity at St Fergus. In this context, implementation before October 2001 would result in Users at both Barrow and St. Fergus paying charges for MSEC which differ from those bid in the auctions. This could be regarded as undermining a fundamental feature of the pay as bid MSEC auctions.

In conclusion Transco is not in support of this Modification Proposal. It is of the opinion that a change to Network Code is not the appropriate route to address differentials in entry capacity charges at specific entry points. Transco considers that blending of gas across the whole system is an unrelated process and should be separated from issues regarding the entry capacity auction charging methodology.

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

The proposer does not state which of the relevant objectives this Modification Proposal is trying to better facilitate.

**4. The implications for Transco of implementing the Modification Proposal , including
a) implications for the operation of the System:**

Transco could be required to substantially increase the monitoring of gas quality levels at the relevant points on the system and determine the gas mixing ratios on a regular basis within the gas day.

b) development and capital cost and operating cost implications:

Development costs are estimated to be significant. Implementation of the Modification Proposal would involve increased daily monitoring and calculation of mixing ratios, thus increasing operating costs. However as Transco is recommending rejection of the Modification Proposal no detailed analysis has been carried out.

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:

Costs of system development would be met from allowed revenues for such purposes.

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

Any implementation may require a change to Transco's charging methodology, in accordance with Standard Condition 3 of Transco's PGT Licence.

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 monitoring and determination of mixing ratios would require the introduction of an off-line system which therefore may increase the likelihood of administrative errors.

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

System changes to support the modification are understood to involve complex reprogramming in respect of the introduction and administration of two new charge types, one of these charges being based on apportioning revenue. It is viewed that the introduction

of variable daily charges and a revenue smearing mechanism would necessitate manual daily processes by Transco.

7. The implications of implementing the Modification Proposal for Users

Implementation of the Modification Proposal would require User system changes to accommodate the new charge types. Users may not have the benefit of having advanced notice of their entry capacity prices at these terminals.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

No such implications are anticipated.

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

Consideration would need to be given to any potential breaches of commercial confidentiality clauses that may arise from the provision of supporting data associated with the relevant invoices.

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

Advantages :-

- adjust Barrow entry charges to reflect the value of dependence upon St Fergus gas.

Disadvantages :-

- undermines the use of capacity auctions to determine entry capacity charges at these entry points.
- the introduction of two new charge types and changes to billing systems
- increased complexity due to the daily monitoring and calculation of mixing ratios.
- apportionment of capacity charges via neutrality charges may benefit Users buying capacity outside the MSEC auction process.

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

Representations are now sought on this draft modification report.

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.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) or the statement furnished by Transco under Standard Condition 3(1) of the Licence

Transco is unaware of any such requirement.

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

Transco is not in support of this Modification Proposal and therefore has not developed such a programme of works.

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

Transco does not recommend implementation and therefore has not proposed an implementation timetable.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends rejection of this Modification Proposal.

17. Transco's Proposal

17. Text

18. Text

Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date: