

Draft Modification Report
Amendment to the Entry Overrun Charge
Modification Reference Number 0119

Version 1.0

This Draft Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 9.6.

1. The Modification Proposal

The Proposal was as follows:

“Under the current regime, Users who are intending to deliver gas at an Aggregate System Entry Point (ASEP) are provided the opportunity to purchase NTS Entry Capacity through capacity auctions. If a User delivers gas onto the System over a Gas Day at an ASEP in excess of the level of its NTS Entry Capacity holdings at that ASEP, then the User will incur an overrun charge.

The overrun charge is based on the quantity of gas by which the User has overflowed its NTS Entry Capacity holding multiplied by an overrun price. The overrun price is the greatest of the following prices applicable to the ASEP and Gas Day concerned:

- $(8 * A)$ where A is the highest bid price paid by National Grid NTS in relation to any capacity bid accepted in respect of the Day or the Gas Year in which the Day falls;
- $(1.1 * B)$ where B is the highest of the:
 - average of the top 25% of accepted offers prices
 - average of the top 25% of accepted forward prices
 - average of the top 25% of accepted exercise prices

The intent of the overrun charge is to encourage Users to purchase NTS Entry Capacity consistent with their flow requirements and secure a right to flow gas onto the System. This in turn provides National Grid NTS with a signal as to how the System is intended to be used. However, under certain circumstances, this incentive is negated under the current overrun price arrangements and could encourage Users to take up an overrun position due to conflicting financial incentives. This is explained below:

- The overrun price A is determined by identifying the highest bid price relating to an allocated bid in any of the annual monthly auction (AMSEC), rolling monthly auction (RMSEC) or the daily auctions (WDDSEC or DADSEC). Under certain circumstances the highest bid price can be zero (where the reserve price is set at zero for the ASEP in these auctions) which can then create a zero overrun price. This results in a possibility that a User could decide not to purchase NTS Entry Capacity and then deliver gas onto the System in excess of their capacity holdings and incur a zero overrun charge. Although the purchase of the capacity would have been at zero price, National Grid NTS would have not received the signal through the appropriate auction of the intended use of the system. It is also possible that if no bids are received for capacity at an ASEP with a reserve price

greater than zero, then any subsequent flows would result in a zero overrun charge – regardless of the level of the reserve price;

- The overrun price B can result in a position whereby a User may obtain more revenue from the surrender of capacity to National Grid NTS than it would incur from the resulting overrun charge in the event that the User did not change its flows in accordance with the accepted buy back offers. This is due to the use of the average of the top 25% of accepted constraints management action prices in determining the overrun price.

National Grid NTS considers that it is important to remove these adverse incentives created by the current overrun arrangements. It is therefore proposed that the calculation of the applicable overrun price is amended to be the greatest of:

- $(8 * A)$ where A is the highest bid price paid by National Grid NTS in relation to any capacity bid accepted in respect of the Day or the Gas Year in which the Day falls;
- $(1.1 * B)$ where B is the *highest* accepted offer, forward or exercise price in respect of the Day;
- $(8 * C)$, where C is the *highest reserve price under any invitation for the Day or Gas Year in which the Gas Day falls.*

National Grid NTS believes that if this Proposal were not to be implemented then the continuation of the perverse incentive on Users under the current overrun arrangements to not secure NTS Entry Capacity could lead to inaccurate signals of intended use of the System and higher constraint management costs than could be the case.”

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

The Proposer considered “this Proposal would, if implemented, better facilitate the Relevant Objective in respect of Standard Special Condition A11 paragraph 1(a) as set out in its Gas Transporters Licence for the following reasons:

- The Proposal would result in more efficient management of constraints at an ASEP by removing the incentive on Users to overrun where their accepted offers are within the top 25% of all accepted offers for the Day. The proposed use of the marginal price for the calculation of the overrun price would remove any incentive for the User to offer back their NTS Entry Capacity and not appropriately reduce their flows. This could reduce the level of constraint actions and costs, thereby better facilitating the efficient and economic operation of the pipeline system.
- The Proposal would enable National Grid NTS to more economically and efficiently manage the pipeline system by removing the incentive on Users to not book NTS Entry Capacity by reducing the likelihood of the application of a zero overrun price. This would ensure that National Grid NTS receives accurate signals through capacity auctions of the Users’ intended use of the NTS.”

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

The Proposer believed that this Proposal, if implemented, “would better facilitate the operation of the System and enhance security of supply by removing the incentive on Users to overrun on a constraint day. In addition, by encouraging Users to book their capacity requirements it will provide information to National Grid NTS regarding Users’ intended use of the system and enable National Grid NTS to better plan the operation of the system accordingly.”

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

The Proposer considered that this Proposal, if implemented, “would improve the operation of the System. By removing the incentive on Users’ to overrun on a constraint day it will allow National Grid to more efficiently manage a constraint. In addition by encouraging Users to book their capacity requirements it will provide better information to National Grid NTS regarding Users’ intended use of the System and enable National Grid to plan the operation of the System accordingly.”

b) development and capital cost and operating cost implications:

The Proposer believed this Proposal, if implemented, “would have cost implications related to the delivery of the required system changes. However, these costs are expected to be low.”

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

The Proposer believed that this Proposal, if implemented, “would require it to recover the costs associated with the system development.”

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

The Proposer did not believe this Proposal, if implemented, “would have any consequences on price regulation.”

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The Proposer believed that the Proposal, if implemented, “has no impact on the level of contractual risk of each Transporter.”

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications

for the UK Link Systems and related computer systems of each Transporter and Users

The Proposer envisaged that “this will have a minimal impact on the UK Link System if this Proposal were to be implemented.”

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The Proposer believed that this Proposal, if implemented, “would not increase the level of contractual risk on Users.”

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

No such implications have been identified.

9. Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No such consequences have been identified.

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

Advantages

The Proposer believed that this Proposal would:

- “remove the perverse incentive for Users to not respond to accepted constraint management actions where their offer, forward or exercise price is within the top 25% of accepted prices;
- result in potentially lower constraint management costs on behalf of all Users;
- better target constraint costs to those that create such costs;
- encourage Users to book their capacity requirements to reflect their intended flows and thereby provide National Grid NTS with better signals to support operation of the NTS.”

Disadvantages

- none identified

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

Written Representations are now sought in respect of this Draft Report

12. The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

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

No Programme for works has been identified.

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

The Proposer suggested an implementation date of 1st April 2007.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

18. Transporter's Proposal

19. Text

**UNIFORM NETWORK CODE – TRANSPORTATION PRINCIPAL
DOCUMENT**

SECTION B – SYSTEM USE AND CAPACITY

Delete existing paragraphs 2.12.3, 2.12.4 and 2.12.5 and replace with the following

“2.12.3 The System Entry Overrun Charge shall be calculated as the amount of the overrun quantity multiplied by whichever is the greatest of:

- (a) $(8 * A)$, where 'A' is the highest bid price in relation to a capacity bid in respect of which NTS Entry Capacity was allocated following an invitation under paragraphs 2.2, 2.3 and 2.4 in respect of the Day, or the month or quarter in which the Day falls (as the case may be); and
- (b) $(1.1 * B)$, where 'B' is the highest accepted offer price, highest accepted forward price or highest accepted option price paid by National Grid NTS in respect of any Capacity Management action taken in respect of the Day; and
- (c) $(8 * C)$, where 'C' is the highest reserve price specified in an invitation under paragraphs 2.2, 2.3 and 2.4 in respect of the Day, or the month or quarter in which the Day falls (as the case may be);

where (a), (b) and (c) are calculated by reference to information available to National Grid NTS at 02:00 hours on the relevant Day.

2.12.4 For the purposes of paragraph 2.12.3(b), in respect of an Aggregate System Entry Point:

- (a) the "highest accepted offer price" for a Day is the highest offer price paid by National Grid NTS pursuant daily capacity offers accepted in accordance with paragraph 2.10 in relation to that Day;
- (b) the "highest accepted forward price " for a Day is the highest price paid by National Grid NTS pursuant any Forward Agreement in relation to that Day; and
- (c) the "highest accepted option price" for a Day is the highest price paid by National Grid NTS pursuant any Option Agreement in relation to that Day.

2.12.5 Where on any Day National Grid NTS makes a Constrained Storage Renomination in respect of the Storage Connection Point of a National Grid LNG Facility then, subject to the proviso below, the System Entry Overrun Charge for a User in respect of the National Grid LNG Facility shall be zero for any overrun quantity but only to the extent and for such part of that Day that the implied rate derived from the Constrained Storage Renomination exceeds the implied rate derived from that User's Registered Storage Deliverability (as defined in Section Z) (in both cases for that LNG facility). This paragraph shall

only apply in respect of a User where that User sends written notification to National Grid NTS within 3 Business Days of the relevant Day stating (a) that the zero rate is to apply; (b) the overrun quantity and the period for which it is to apply; and (c) reasonable evidence to support its claim.”

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

Subject Matter Expert sign off:

I confirm that I have prepared this modification report in accordance with the Modification Rules.

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters

Signature:

Date :