Modification Report
Further Release of Within Day Capacity
Modification Reference Number 0392
Version 2.0

This 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 proposes that Transco should release up to 20% of day ahead aggregate system entry capacity as use-it-or-lose-it interruptible capacity within day. The original proposal suggested that this should be implemented in time for the April to September 2000 System Entry Capacity auctions.

2. Transco's Opinion

Transco does not support this proposal.

During the discussions held by the Modification 0365 Development Workgroup, the availability of an appropriate volume of interruptible entry capacity was fully discussed. It was recognised that there were significant concerns regarding the reduction in the volume of interruptible entry capacity to be made available from June 2000, particularly in relation to the ability to place bids on the OCM and the perceived illiquidity of the secondary market. In light of these concerns, Transco proposed that as a transition measure an amount of interruptible capacity, equal to 10% of Monthly System Entry Capacity at each terminal should be offered in addition to use-it-or-lose-it interruptible capacity. The release mechanism for Interruptible Capacity has been developed for use at the day-ahead stage only. At present no within day capability exists for the release of Interruptible Capacity. Initially discussions had focused on reducing provision of Interruptible use-it-or-lose-it capacity only. Ofgem directed Transco to implement the Modification proposal in this revised form.

Transco is of the opinion, therefore, that the proposer's concerns have already been addressed and that this Modification Proposal should not be implemented. As the April to September 2000 Entry Capacity auctions have now been completed, Transco believes it would be inappropriate to introduce this proposal "mid term" and considers that the volumes of both firm and interruptible entry capacity should be debated with a view to introducing any further amendments in October 2000.

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

The proposer argues that the Modification Proposal will "improve the economic and efficient running of the system". The release of increased quantities of interruptible capacity may enhance liquidity on the OCM and overcome inefficiencies in the trading of capacity on the secondary market.

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

a) implications for the operation of the System:

If implemented, the increase in the volume of interruptible capacity released will reduce the probability that Transco will be required to buy back in circumstances where interruptible capacity is bought and utilised in preference to firm capacity.

b) development and capital cost and operating cost implications:

Transco would incur further IT development costs if this proposal is implemented as a mechanism to release within day interruptible capacity would be required.

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

Any additional development and ongoing costs would be accounted for under the price control formula and Transco would not intend to seek to recover costs for the provision of this proposal in the present formula period.

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

This proposal would not be anticipated to have immediate price regulation consequences. However, the increase in the volume of interruptible entry capacity available may have an effect on the bidding strategy of User's in the monthly capacity auctions and therefore may have an impact of the level of revenue Transco recovers through Monthly System Entry Capacity, which will feed through to 'k' in the present price control formula.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

Transco's level of contractual risk may be reduced if increases in the volume of interruptible entry capacity sold replace sales of daily firm capacity, therefore reducing Transco's exposure to buy back in circumstances where the additional quantities cannot be accepted at the ASEP in question.

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

At this juncture Transco has not developed the functionality to offer within day interruptible entry capacity. To develop such functionality would require significant systems development. Transco would also need to develop functionality to calculate interruption factors for quantities of interruptible capacity which only relate to part of a gas day.

7. The implications of implementing the Modification Proposal for Users

Users will have access to increased volumes of interruptible entry capacity, which they may purchase to avoid bidding for firm capacity on the within day market or, alternatively, avoid exposure to overrun charges.

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

The use of increased quantities of interruptible entry capacity may dampen the signals on the intended sourcing of gas, which would otherwise be supplied through Users booking firm entry capacity only.

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

No significant consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party are anticipated as a result of implementation of this proposal.

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

Advantages :

Provides an increased volume of low cost entry capacity.

The incentive for Users to retain entry capacity for possible within-day use, in preference to offering it for trade, may be diminished.

OCM liquidity may be increased as the need to secure firm capacity before bids are placed would be reduced.

Provides Users with an additional means of securing entry capacity, albeit on an interruptible basis, to mitigate the risk of overrun.

May lead to lower average capacity charges

Disadvantages :

Potentially undermines liquidity in the secondary trading of firm entry capacity.

Increases the likelihood of Users obtaining a firm service on an interruptible price in circumstances where system conditions change to the extent that no interruption is required.

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

Representations to the draft Modification Report have been received from Total Oil Marine (TOM), Alliance Gas (AGL), Scottish and Southern Energy (SSE), British Gas Trading (BGT), Shell Gas Direct (SGD) and Total Gas Marketing (TGM).

TOM, TGM, AGL and BGT believe that it would be inappropriate to introduce amendments to the capacity regime now that the April to September 2000 Entry Capacity Auction has already taken place, as this would undermine the basis of Shipper's commercial strategies during the auction.

TOM believes the proposal should be rejected, also stating that it would undermine the ability for Users to sell any unused capacity acquired in the auction at a fair market price which is based on the original auction results.

AGL, TGM and BGT believe that there should be a long term Interruptible Capacity service and that the proposal should be included in the current RGTA III discussions for possible implementation in October 2000. BGT adds that implementation of the service from this date should also allow sufficient time for the associated computer systems to be developed.

BGT does not accept Transco's argument that from 1 June 2000, sufficient interruptible capacity will be provided from a volume of 10% of MSEC plus Use-it-or-lose-it and goes on to suggest that the lack of within day interruptible capacity will restrict Transco's flexibility to release further capacity.

BGT also puts forward the view that there is evidence from the March auctions that the reduction in interruptible capacity from June onwards increased the pressure to secure MSEC capacity. This pressure could be alleviated by a greater degree of certainty about the availability of daily services.

BGT raises concerns that Shippers will retain firm capacity in case it is required later in the day. Under these circumstances Transco would not be incentivised to release further firm capacity due to the risk of buy back or curtailment of firm capacity. A within day interruptible capacity service could, however, avoid the potential cost of restricting firm capacity.

SGD is inclined to support the proposal although it also has concerns over the fact that it would alter the regime after the MSEC auctions have taken place. However, it believes that those concerns are outweighed by disquiet regarding the quantity of capacity being made available by Transco, especially from 1 June 2000. SGD also notes that the Modification had been raised prior to the auction and should only constitute a minor change.

SGD refers to its letter to Transco of 7 April 2000 regarding information issues and stresses that such information is necessary to "facilitate and illustrate the full use of capacity" and clarify to

Shippers how the quantity of capacity made available is determined. SGD raises concerns that not all available capacity is being brought to the market and states that to date no information has been made available to allay these suspicions.

SGD points out that increasing the level of interruptible capacity in isolation will not be a "substitute for greater transparency" and will not guarantee that Shippers will be able to gain access to the capacity that is physically available. However, when compared to the regime which will be in place from 1 June 2000, it believes that this proposal will better facilitate the relevant objectives and should "bring more capacity to the market at a price reflecting the costs of providing it, will increase the efficiency and economy of the current arrangements and will facilitate competition in gas trading".

SSE is in support of the proposal and believes that it should be implemented as soon as possible. Support is expressed for the concept of an interruptible capacity product and it puts forward the view that the marked increase in the prices paid for entry capacity from 1 June onwards was a reflection of the concerns held by Shippers that they may be unable to acquire all the short term capacity necessary to meet their needs, due to the reduction in the volumes of interruptible capacity from this date. SSE also shares the concerns which have been raised by other Shippers over the impact that the reduced volumes of Interruptible Capacity could have on the OCM.

SSE acknowledges that the provision of additional information regarding the volumes of daily firm and interruptible capacity made available to purchase and the changes to the capacity screens which will allow Shippers to see the stack of bids for capacity will help to alleviate some of the concerns, however, it believes that it would be appropriate to release additional interruptible capacity in line with this proposal. The opinion is put forward that this would help to release unused firm capacity to the market, guard against hoarding and help to stimulate trading on the secondary market.

SSE expresses disappointment that constraints in the development of computer systems to facilitate this proposal could delay implementation and requests further clarification from Transco on this issue, adding that it would be unfortunate if a capacity trading system has been developed which cannot be modified quickly to take account of changes to the trading arrangements.

Transco's response :

Transco retains a fundamental concern with the prospect of selling significant quantities of within day interruptible capacity. It does not seem appropriate to be selling an interruptible product at a time when a high degree of certainty regarding a shippers need for the product should exist. That implies that within day interruptible capacity, if sold, would carry a certainty of service that was on a par with the certainties of service associated with a firm within day capacity product. The price, however, would be a substantial discount from firm.

Transco agrees with those respondents that opposed the proposal because it would have the effect of undermining conditions at which shippers had previously bid for firm capacity for the period April through to September 2000. Changing one element of the entry capacity regime could undermine the basis by which shippers selected prices and quantities in the recent MSEC auctions.

Industry participants are in the process of discussing the desirability of developing longer term interruptible capacity for use at entry. Transco believes that such an initiative has merit and could provide further certainty for shippers, in that they will be able to obtain interruptible capacity well before the gas day. A longer term interruptible capacity service may also help demonstrate that Transco is maximising capacity availability. The development of a long term interruptible service will be resource intensive for both Transco and the industry. Consequently Transco would not wish to commit to developing both long term and within day interruptible services at the same time.

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

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

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Implementation is not required as a consequence of any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the License.

14. Programme of works required as a consequence of implementing the ModificationProposal

No development work has been conducted to date in furtherance of this Modification Proposal. It is anticipated that, if approved, system development and acceptance testing could not be completed by 1 October 2000, to coincide with the next auctions of MSEC which are to be held not later than 1 July 2000 unless work on developing Long Term Interruptible capacity is rescheduled.

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

As Transco does not support this Modification no timetable is provided.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not recommend that this Modification Proposal be implemented and therefore no legal text has been provided.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This Modification Report contains Transco's proposal not to modify the Network Code and Transco now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Transco does not support implementation of this proposal and therefore no legal text has been submitted.

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0392**, version **2.0** dated **25/05/2000**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **2.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:

    (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") 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 Authority 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 paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

    provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.

2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.

3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.

4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.