Modification Report
URGENT Modification Reference Number 0271/0272

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.12.4.

1. Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.2(a) Ofgas has agreed that this Modification Proposal should be treated as Urgent because these are proposals raised in response to industry concerns over the balancing costs currently being incurred as a result of transportation constraints which have necessitated flexibility System Sells at the St.Fergus terminal.

These proposal provide a mechanism which may reduce the costs of constraints and requires urgent consideration in view of the costs currently being incurred by the community as a result of constraints affecting St.Fergus.

2. Procedures Followed:

Transco agreed with Ofgas (and has followed) the following procedures for this Proposal;

Issued to Ofgas	22 September
Agreed as Urgent	22 September
Close out for Representations	30 September (5pm)
Report to Ofgas	1 October

3. The Modification Proposal:

Transco have made two modification proposals (0271 and 0272) considering capacity entitlements at constrained terminals.

Modification 0271 proposes that:

Transco will on the preceding day assess the capability of the St.Fergus terminal. This capability will be compared to the aggregate of booked St.Fergus capacity to derive a scaling factor. This scaling factor will be applied to a shippers available System Entry Capacity on the gas day and an overrun will be charged for flows in excess of this scaled capacity availability. Transco will notify shippers of the applicable scaling factor by 14:30 hrs on the preceding day.

It is acknowledged that shippers may have to use the secondary capacity market at short notice to meet their entry capacity requirements. In order to mitigate shipper risk the overrun multiplier in respect of deliveries of gas to the system through the St.Fergus terminal will be reduced to 8 times the daily System Entry Capacity Charge.

Where Transco are of the view that a system sell is required in respect of the St.Fergus terminal, System Sell bids at that entry zone with a price of less than 0 (zero) p/kWh will be rejected.

These measures will apply for a period of 28 days from the approval of the modification after which existing Code provisions will prevail.

Modification 272 proposes that:

In addition to the scaling process described in proposal 271 an additional revised treatment of overruns to include accepted System Sell quantities is proposed as follows;

Where the sum of a User's end of day allocation of gas and accepted System Sell Bids at the terminal exceed the User's Available Restricted System Entry Capacity a charge will be levied. The derivation of this charge will be a two part calculation as follows:

1) Where a shipper's allocation of gas exceeds available Restricted System Entry Capacity a charge shall be levied equal to the quantity by which Available Restricted System Entry Capacity is exceeded multiplied by the greater of:

   8 times the applicable daily entry capacity charge; or

   The amount by which the average price of gas sourced via the flexibility mechanism on the day exceeds the lowest price of gas sourced (if flexibility is taken)

and

2) Where a shipper has had one or more System Sell Bids accepted a charge shall be levied equal to the amount by which the aggregate of the User's allocation and that Users accepted system sell quantity, less the quantity in part 1), multiplied by the greater of:

   8 times the applicable daily entry capacity charge; or

   The amount by which the System Marginal Buy price exceeds the lowest price of gas sourced (if flexibility is taken)

4. Transco's opinion:

Existing Code provisions have allowed shippers to make flow nominations at St. Fergus beyond the available (constrained) capacity. Resolution of the resulting constraints has in turn lead to significant neutrality costs. Modifications which encourage Shippers to nominate and flow within the available capacity may well reduce these costs.

Implementation of 271 would facilitate Ofgas monitoring of Shipper licence compliance.

Many respondents discuss the construction programme associated with the constraints. The capacity expansion has been essential to ensure appropriate winter 98/9 capacity will be available. The programme was planned taking account of best available information about capacity requirements and it was anticipated that flows at St Fergus would face minimal disruptions.

5. **Extent to which the proposed modification would better facilitate the relevant objectives:**

Implementation of either modifications, 271 or 272, will provide an incentive for shippers in aggregate to nominate within the available physical capacity and will create incentives for shippers to trade capacity. This will promote efficient and economic usage of the available capacity

6. **The implications for Transco of implementing the Modification Proposal, including:**

a) **implications for the operation of the System and any BG Storage Facility:**

No additional implications. Current provisions apply.

b) **development and capital cost and operating cost implications:**

Manual processes for calculation of overruns. Limited additional administrative costs.

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

Not applicable.

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

None

7. **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 will have to provide the appropriate factor to determine a Shippers "firm" capacity entitlement ahead of the day.

8. **The development implications and other implications for computer systems of Transco and related computer systems of Relevant Shippers:**

Overrun quantities and charges will be calculated manually.

9. **The implications of implementing the Modification Proposal for Relevant Shippers:**

Shippers will have to modify nomination processes to include the affects of a reduced capacity entitlement. A reduction in constraints cost will reduce neutrality charges which affect all shippers regardless of whether they ship gas at the affected terminal.

Shippers face increasing contract risk as they will be unable to know their capacity entitlement until day ahead.

10. **The implications of implementing the Modification Proposal for terminal operators, suppliers, producers and, any Non-Network Code Party:**

The will have increased risk as they now have to manage to a firm capacity rights at affected terminals.

11. **Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each Relevant Shipper and Non-Network Code Party of implementing the Modification Proposal:**

These modifications would entail a fixed period amendment to Network Code terms.

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

Advantage:
1. Facilitate capacity definition.
2. Shippers aware of firm rights.

Disadvantage:
1. Arbitrary allocation of capacity rights.
2. Lack of liquid secondary market.

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

The following table summarises the Shipper responses to the Modifications;

SHIPPER	MOD 271	MOD 272
Amerada	No	No
Amoco	No	No
Agas	No	No
BGT	Yes and changes	No
MEB	Comment on Noms only?	
Mobil	No	No

SHIPPER	MOD 271	MOD 272
Accord	Yes	No
United	No	No
Elf	No	No
British Steel	General commens on balancing or firm	
Enron	No	No
Total	No	No
Vitoil	No	No
Powergen	No	No
Shell	No	No
Hydro	No	No
Quantum	No	No
Alliance	Yes	Yes
Southern	No	Yes
GL&C	No	No
Conoco	No	No
National Power	No	No
Yorkshire	No	No
Marathon	No	Yes
Totals		
24 Representations	19 No 3 Yes 2 General Comments	19 No 3 Yes 2 General Comments

Conoco remarked that the proposals are inappropriate, they clearly cost target in the vicinity of the constraint despite the overwhelming response to the consultation that preceded the Mod 265/265a proposals.

Conoco also expressed a concern that the proposals could generate a 'run' on capacity when shippers purchase more annual capacity to seek a larger proportion of the available capacity. Whilst this is a theoretical possibility, it seems unlikely that given the temporary return of the proposed modification that such action would be commercially attractive.

Both **Amerada** and **GAS** make the same general points on capacity definition and that a long term solution has been the subject of considerable debate for a number of years, with no resolution. **Amerada** and **GAS** make the point that the current constrained levels at St. Ferrous are below the levels of capacity stated by Transact on the 15th June 1998, and would like to see Transact attributed with the costs associated with the difference in Transco's stated level (15 June) and the actual level at which constraints have been called. Several other Shippers indicated that there should be some refund of capacity charges where Shippers have been unable to reach desired flows.

Several Shippers including Scottish Hydro Electric express disquiet that firm capacity entitlement could be removed without compensation is unacceptable. However, it is essential to note that the Network Code was based on the principle that capacity was sold on the lines of annual tranches, with incentives to look to meet peak requirement. The Code recognised that this could give rise to constraints and so Code envisaged the use of the flexibility mechanism to resolve such constraints.

Several Shippers, in particular **Scottish Hydro,** recognise that it is necessary to take short term temporary changes to prevent costs distortions, but that it is also urgent that the underlying problem of entry capacity service definition is addressed in an appropriately short time scale.

Scottish Hydro assert that it is inappropriate to target costs at St Fergus via these Modifications. Shippers with little flexibility may not be able to easily adjust the flows and so would be faced with large costs. Such Shipper have not profited from events of recent weeks and hence, it is unjust that the remedy to the constrain issue should fall most heavily on such Shippers. This echoes the comments of several other Shippers including **Quantum** that the Modifications would be unfair to those Shippers who have associated gas constraints with flexibility but fail to address these Shippers with large flexibility who are the ones that have had the capability to benefit from recent events.

Amerada did not comment on the detail of the modifications, since they thought them generally unacceptable, however, they made the observation that the proposed capacity overrun charges do not appear to be creditted to Neutrality, a point also picked up by **British Gas Trading.** However, drafting in 10.4/5 indicates that any excess revenue over that which would have resulted from capacity matters in the current regime will be credited to neutrality.

Amerada did not comment on the detail of the modifications, since they thought them generally unacceptable, however, they made the observation that the proposed capacity overrun charges do not appear to be creditted to Neutrality, a point also picked up by **British Gas Trading.**

AGAS and **Mobil** do not consider that the modifications would have the desired impacts on constraints as supply contracts at St Fergus offer little flexibility and thus the mod will have little impact on the gas being landed, gas would remain unclaimed and Transco would need to respond by physical curtailment. **AGAS** consider that the current mechanism has been effective in resolving the constrint.

AGAS also consider that these modifications will lead to contractual default, a point echoed by **Mobil**, and **AGAS noted** that the possibility of legal action should not be underestimated.

On the subject of using a secondary market for capacity **AGAS, Amoco and Mobil** point out that this market is illiquid and dominated by one player who may take advantage of their position by charging for capacity at just under the overrun level. **AGAS** also consider that this modification would lead to shippers paying twice for their capacity service, a comment echoed by **United, Amoco and Mobil.**

MEB Midland Sales Ltd do not state whether they are for or against the modification, but make the observation that the pro-rating of capacity should be on the basis of nominations and not booked levels.

Accord energy support modification 271, on the basis that account is taken of their objections to Mod 265/265A. They are opposed to Mod 272.

British Gas Trading support Modification 271, but do not support 272. In supporting 271 **British Gas Trading** consider Modification 265/265a to be unnecessary and unacceptable. **British Gas Trading** would like to see the follow clarifications/amendments:-

a) Confirmation that shrinkage is allowed for in the determination of capacity.
b) notification of revised capacities at demand attribution times.
c) an understanding of the implications of capacity trading
d) reimbursment of capacity charges for capacity unavailable during the day.
e) acceptance of negative sell bids, but only paying 0p.

Transco Response:

Transco believe that the current level of costs being generated at St Fergus to resolve system constraints is unacceptable.

These costs are giving rise to smeared costs over the last month of around 3/4 p/therm of throughput.

If this is allowed to continue it may jeopardice the viability of some shippers.

Transco recognises that the longer term solution may well involve firm capacity definition but in the meantime it is essential that steps are taken to at least contain, and preferably reduce, the costs of constraint resolution.

Transco believe that these proposals may significantly reduce the level of costs via neutrality.

The proposals will provide very strong incentives on shippers to flow gas in line with their capacity "entitlement" which will be prorated down from booked levels. This will encourage shippers to either nominate in line with currently held capacity "entitlement" or to seek extra capacity on the secondary market.

Transco accept the fact that shippers with no ability to turn gas down will be forced to purchase capacity on the secondary market and that it has been suggested that that market might be illiquid. It is clear that capacity at St Fergus will have a significant value, albeit one potentially capped by the overrun charge. Transco anticipate that there is sufficient scope for flexible gas to make way for the access of oil and condensate related gas to get access.

The secondary capacity market, in a environment of much firmer "rights", will ensure that if required all physical capacity will be used.

Additionally data on all such secondary capacity transactions can be provided to Ofgas so that they can consider the effectiveness and efficiency of such secondary trading.

Additionally it is anticipated that the "unavailable" proportion of capacity will be small so that whilst there may be high potential secondary capacity or overrun charges associated with marginal flows the impacts over theshippers total gas flows may be quite small.

The principle determinant of costs at present is the use of flexibility to resolve constraints. The modifications, to varying extents, may help in this respect.

In respect of Modification 271 shippers who are nominating beyond their "entitlements" will be identified for possible regulatory scrutiny.

Modification 272 goes much further,. This features strong commercial incentives not to nominate or flow gas in excess of "entitlement". It would also reduce the likelihood of shippers nominating high in respect of gas deliveries in expectation of getting flex sells accepted and then flowing gas within "entitlement".

If onshore costs are to be reduced it is essential that the volume of flexibility used to resolve the constraint is reduced. These proposals would have that effect; Transco would not expect that the overruns would generate significant income to neutrality as Transco believe that the secondary market will ensure that such overruns are avoided.

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

Not applicable

15. **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:**

Not relevent.

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

Manual calculation of overrun charges to be undertaken by Commercial Operations. A programme of works is not required.

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

Implementation on 1st October for Gas day 2nd October. First 14:30 D-1 notification of available capacity would be on the 1st October.

18. **Recommendation concerning implementation of the Modification Proposal:**

Transco recommend implementation of modification proposal 0271.

19. **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.

20. **Transco's Proposal:**

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

21. Text provided pursuant to Rule 9:

Mod 271 - Transition Document, Part II

10. Restricted Entry Capacity

10.1. For the purposes of this paragraph:

(a) a **"Restricted System Capacity Point"** is an Aggregate System Entry Point specified in the table below;

(b) the **"Restricted Capacity Factor"** in relation to a Restricted System Entry Point for any Day is the lesser of one (1) and:

(i) the quantity estimated, not later than 14:30 hours on the Preceding Day, by Transco (by reference to estimates of supply and demand and such other information as it judges relevant), as the aggregate maximum quantity of gas of which Transco will be able to accept delivery during the Gas Flow Day at the Restricted System Entry Point, divided by

(ii) the aggregate of the System Entry Capacity which Users are registered as holding at the Restricted System Entry Point on the Day;

(c) a User's **"Available Restricted Capacity"** in relation to a Restricted System Entry Point for any Day is the User's Available System Entry Capacity multiplied by the Restricted Capacity Factor for that Day.

Table

Restricted System Entry Point	Relevant multiplier	Period (in Days)	Effective date
St Fergus	8	28	[Not specified]

10.2 This paragraph 10 shall apply in relation to each Restricted System entry Point for the period specified in the table in paragraph 10.1, commencing on the date specified in that table, or if no such date is specified commencing on the date of the Code Modification pursuant to which such System Entry Point was specified as a Restricted System Entry Point.

10.3 Transco will, not later than 14:30 hours on the Preceding Day, notify to all Users the Restricted Capacity Factor for each Restricted System Entry Point.

10.4 In relation to a Restricted System Entry Point, Sections B2.5 and 2.6 shall not apply, and in lieu thereof the following provisions shall apply:

(1) If for any reason on any Day the quantity of gas delivered by a User to the System at a Restricted System Entry Point exceeds the User's Available Restricted Capacity, the User shall pay a charge (**"Restricted Entry Overrun Charge"**) in respect of System Entry Capacity at the Restricted System Entry Point on that Day:

(2) The Restricted Entry Overrun Charge shall be calculated as the relevant multiplier (specified in the table in paragraph 10.1) multiplied by the Applicable Daily Rate of the System Entry Capacity Charge multiplied by the overrun quantity:

(3) For the purposes of paragraph (2), the overrun quantity is the amount, if any, by which sum of the User's UDQIs on the Day in respect of each System Entry Point comprised in the Restricted System Entry Point exceed the User's Available Restricted Capacity:

(4) The Restricted Entry Overrun Charge shall be invoiced and payable in accordance with Section S;

(5) The amount by which (1) the aggregate of the Restricted Entry Overrun Charges payable by a User in respect of a Restricted System Entry Point in relation to Days in a month exceeds (2) the amount, if any, which would have been payable in relation to that month by the User under Sections B2.5 and B2.6 in respect of that Restricted System Entry Point, shall be additional Monthly Adjustment Neutrality. Revenue is relation to that month for the purposes of Section F4.5.3(b)(iv).

10.5 For the purposes of Section B2.2.5, the time by which an application for System Entry Capacity at a Restricted System Entry Point may be withdrawn shall be 13:00 hours on the Day preceding the proposed date of registration.

10.6 Transco will not accept any Flexibility Bid pursuant to Section D1.5 for a System Sell at any System Entry Point comprised in a Restricted System Entry Point for which the Bid Price is negative (as described in Section D2.6).

10.7 For the avoidance of doubt, Transco will not be required to take action under Section D1.6 to the extent that there are insufficient Flexibility Bids (open for acceptance pursuant to paragraph 10.6) to avoid the relevant Transportation Constraint at a Restricted System Entry Point.

Signed for and on behalf of Transco.

Signature:

John Lockett
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 **[271/272]**, version **[1.0]** dated **[01/10/98)** be made as a modification to the Network Code.

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

Signature:

Rebecca Purves
Head of Gas Balancing
Date:

The Network Code is hereby modified, with effect from , in accordance with the proposal as set out in this Modification Report, version **[1.0]**.

Signature:

Process Manager - Network Code
Transco

Date:

ANNEX

Restrictive Trade Practices Act - Suspense Clause

For the purposes of the Restrictive Trade Practices Act 1976, this document forms part of the Agreement relating to the Network Code which has been exempted from the Act pursuant to the provisions of the Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996. Additional information inserted into the document since the previous version constitutes a variation of the Agreement and as such, this document must contain the following suspense clause.

1. **Suspense Clause:**

1.1 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect:

(i) if a copy of the Agreement is not provided to the Director General of Gas Supply (the "Director") within 28 days of the date on which the Agreement is made; or

(ii) if, within 28 days of the provision of the copy, the Director gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraph 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996.

provided that if the Director does not so approve the Agreement then Clause 1.2 shall apply.

1.2 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect until the day following the date on which particulars of this Agreement and of any such arrangement have been furnished to the Office of Fair Trading under Section 24 of the Act (or on such later date as may be provided for in relation to any such provision) and the parties hereto agree to furnish such particulars within three months of the date of this Agreement.