Modification Report
Temporary Extension of Absolute Tolerance Quantity
Modification Reference Number 0386
Version 5.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

Modification Proposal circulated to industry	15 February 2000
Close out for Representations	18 February 2000
Final Modification Report to Ofgem	23 February 2000
Ofgem decision expected	28 February 2000

1. The Modification Proposal

Quantum Gas Management suggested that:

In modification proposal 251, Enron Direct argued that the Absolute Tolerance Quantity ("ATQ") should be made a permanent feature of the Network Code. Transco responded with Modification Proposal 251(a), which requested a temporary extension of ATQ "given the ongoing nature of developments in the Energy Balancing Regime". Ofgem agreed to implement 251(a) based on a temporary extension of ATQ to 29 February 2000.

ATQ should remain in force until such time as a tolerance service is made available. In the absence of tolerance service and ATQ, there is a risk that small shippers face extinction due to a greater exposure to System Marginal Prices ("SMPs").

Smaller shippers tend to have fewer DM sites and tend to source their gas from the NBP rather than the beach. They therefore have a relatively small Imbalance Tolerance Quantity (below ATQ) with which to balance in order to avoid the risk of potentially high SMPs. NDM shippers also tend to be more susceptible to proportionately higher within day demand swings, and therefore face a greater balancing risk. The removal of ATQ without the back-to-back provision of tolerance services therefore effectively discriminates against smaller shippers by putting their future in jeopardy and acts as a barrier to the entry of new market participants.

While it is in the interests of the community to reduce balancing costs, ATQ itself represents a very small proportion of shipper throughput. As Ofgem and Transco have conceded in the past, the cost of ATQ to the system as a whole is small.

2. Transco's Opinion

ATQ and CITQ were first extended under Modification Proposal 0102 for a six month period and then under Modification Proposal 0172 for a twelve month period (the latter Modification was effective from 1 September 1997). On 24 July 1998, Enron raised Modification Proposal 0251 for permanent extension of ATQ and CITQ and, in response, Transco raised an alternative Proposal 251A for a temporary extension of ATQ and CITQ on 31 August 1998. Implementation of Modification Proposal 0251A resulted in ATQ/CITQ extension to 29 February 2000.

The current proposal by Quantum Gas Management seeks a further extension of ATQ and CITQ until provision of a tolerance service, which, subject to implementation of Modification Proposal 0373, could be available on 1 June 2000. Quantum Gas Management has argued that in the interim period between expiry of ATQ and CITQ on 29 February 2000 and the start of a tolerance service, "smaller shippers face extinction due to a greater exposure to System Marginal Prices".

ATQ and CITQ were introduced to provide some level of protection against balancing risk exposure, arising from the introduction of the Network Code. Much of this exposure arose from inadequate sources of within day gas and a lack of alternative balancing tools.

Even when Modification 251A was implemented, many of the issues which ATQ and CITQ were designed to mitigate had been or were to be resolved. Since then, further improvements to the gas balancing regime have been introduced, particularly from 1 October 1999 with RGTA and introduction of the OCM. In addition, alternative balancing tools and services have been developed and provided by other market participants.

Transco would therefore argue that the removal of ATQ and CITQ should not lead to the demise of smaller shippers.

However, Transco accepts that, given the potential number and impact of changes to the Network Code over the coming months, the retention of ATQ and CITQ for a further three months is unlikely to have a major impact on the regime or the participants. Furthermore, it is unlikely to lead to material mis-allocation of costs within the regime. Shippers may, however, be involved in additional costs if the ATQ and CITQ regime is removed for an intermediate period before the introduction of tolerance services. Should this Modification Proposal not be implemented and Modification Proposal 0373 be implemented, then shippers would face three different cashout regimes over the next four months.

Transco therefore sees merit in the Modification Proposal in the present circumstances.

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

This Modification Proposal could better facilitate condition 7(c), the securing of effective competition between relevant shippers and relevant suppliers, in so far as allowing small shippers to effectively compete with large shippers. Retention of ATQ will ensure that shippers are not exposed to short-term changes which may disrupt their operations prior to the potential implementation of Modification Proposal 0373.

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

a) implications for the operation of the System:

Transco does not envisage any significant impact on System Operation.

b) development and capital cost and operating cost implications:

As the Modification Proposal seeks to extend an existing facility, there will be no development costs. Implementation would avoid some minor operational costs associated with IT system and administration process changes.

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:

There is no requirement for Transco to recover costs in this case.

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

Transco is not aware of any impact on price regulation.

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 is not aware of any increased contractual risk as a result of this Modification Proposal.

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

Transco and Shippers would need to ensure that their systems continue to operate on the basis of ATQ and CITQ functionality which was due to end on 29 February 2000. Transco requests that a decision on this Proposal is made before 29 February 2000 so that any system changes, if necessary, can be made prior to the ATQ expiry date.

Should a decision not be made before the end of February 2000, AT-Link will display information on provisional shipper cashout quantities and sums that could be misleading.

Implementation of this Modification Proposal would prevent Users from needing to make system changes.

7. The implications of implementing the Modification Proposal for Users

Tolerances reduce the volatility of imbalance cashouts and it is the view of small shippers that may not have access to within day gas supplies, that they benefit in terms of reduced exposure.

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

Transco is not aware of any implications for terminal operators, suppliers, producers, and any non Network Code party.

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

Transco is not aware of any such consequences.

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

Advantages:

ATQ and CITQ provide some protection against SMP exposure.

Continuation of ATQ and CITQ would avoid the need for both Transco and Shippers to make changes to their systems to take effect from 1 March 2000.

Continuation of ATQ to the start of provision of a tolerance service would help ensure a relatively smooth transition to a new tolerance regime.

Disadvantages:

ATQ extension has the potential for some gas users to be cashed out at a price which does not reflect the true value of their imbalance, thereby generating an enhanced risk of poor cost allocation.

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

Representations were received from nine Shippers; seven expressed support for the Proposal whilst two were against.

The Gas Light and Coke Company, Reepham Ltd, Norweb Gas, Enron, AgipUK, Elf Gas and Power Ltd and TGM all support the Proposal. They argue that it is vital to protect smaller Shippers from excessive risk exposure until a suitable tolerance is made available. Reepham Ltd suggested that ATQ should not be removed at all, regardless of the provision of any tolerance service.

Aquila Energy and Scottish Power do not support the proposal. They argue that all Shippers have access to a wide variety of sources of swing at market prices, and should be exposed to the same market forces to avoid cross subsidy between efficient and inefficient Shippers. Scottish Power suggested that the temporary extension should expire on 31 March 2000, with a further reduction in ITQ as per Modification Proposal 0381.

Transco Response:

Transco's view in section 2 encapsulates the shipper views summarised above. In addition, Transco would point out that should the introduction of the tolerance service envisaged in Modification Proposal 0373 be delayed, then Transco would see merit in a further extension. If the tolerance service envisaged under Modification Proposal 0373 is not implemented, then the ATQ and CITQ regime should end unless a subsequent proposal is brought forward and approved.

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

This Modification 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

This Modification is not required to comply with the above clauses.

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

In so far as a decision is made before 29 February 2000, no additional significant work will be required to support implementation.

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

Transco recommends an implementation date of 1 March 2000.

16. Recommendation concerning the implementation of the Modification Proposal

It is recommended that Modification 386 be implemented from 1 March 2000 until such time as a tolerance service is made available.

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 to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Transition Document, Part II, Paragraph 1
In paragraph 1.1 (ii), after "for the purposes of paragraph 6,":

delete "29 February 2000 (inclusive)" and insert "31 May 2000 (inclusive)".

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 **0386**, version **5.0** dated **23/02/2000**) 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 **5.0**.

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 <u>(whether such approval is actual or deemed by effluxion of time)</u> 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, <u>had it not been repealed, would</u> 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) <u>or 2(2)(b)(ii)</u> 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.