URGENT Modification Report
Introduction of a 'potential Buy Back' notification and discrete window for Buy Back activity
Modification Reference Number 0491

Version 1.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because the effective start date of the allocation of capacity from the latest entry capacity auction is the 1 October 2001. The proposal recognises that the implementation of Modification Proposal 0481- Release of ASEP maximum system entry capacity volume for the MSEC auction, may affect Transco's management of the capacity buy back process from the effective start date. Urgent procedures were considered necessary to allow consideration of this proposal in the short period of time prior to this date.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Issued to Ofgem for decision on urgency	24 August 2001
Proposal agreed as urgent	28 August 2001
Proposal issued for consultation	29 August 2001
Close out for representations	05 September 2001
Final report to Ofgem	10 September 2001
Ofgem decision expected	13 September 2001

1. The Modification Proposal

TotalFinaElf Gas and Power Limited suggested that:

We propose that in the event of Transco determining there to be a likelihood of the need for buy back activity that they signal this possibility to shippers via an ANS message. This message will advise that Transco may require shippers to reduce their inputs by offering to sell capacity back to Transco. Furthermore we propose that Transco will undertake to conduct and complete any necessary buy back action during a 15-minute window commencing from the start of the next hour bar.

2. Transco's Opinion

In order to facilitate the acceptance of buy back bids within a restricted time window it would be necessary to introduce additional functionality into the capacity RGTA system. This would take the form of a formal window of opportunity for the 15 minutes following

every hour bar in which Transco would be able to accept buy back bids. This would therefore preclude the acceptance of any buy back bids outside of this time window.

Transco agrees that the implementation of Modification Proposal 0481 may increase the likelihood of capacity buy back activity and thus increase the frequency of buy back actions. Consequently, Transco would not want to be restricted in respect of the timing of its actions. Transco may need to take actions at any time during the hour bar in response to physical flow and/or nomination information. Transco therefore believes that the buy back window of 15 minutes at the start of the hour bar is too restrictive, and that in line with the discretion provided under the Operational Guidelines Transco should be able to utilise the capacity buy back market whenever it deems it commercially or physically appropriate.

Restrictions on the timing of buy back actions could have implications for the efficient operation of the system. In circumstances where beach inputs need to be curtailed within the hour bar, and buy back is a primary tool available to Transco, Transco might not be able to manage capacity constraints in an efficient manner.

Another consequence of Modification Proposal 0481 may be a potentially large increase in the number of within day capacity transactions, including shipper to shipper trades, which could cause a deterioration in the RGTA system performance. Introduction of a discrete window of opportunity for access to the buy back market could further intensify activity on the system and lead to further deterioration in system performance.

Transco does not believe that restricting buy back actions to a 15-minute window will lead to more efficient utilisation of its resources. Indeed, the additional processing of buy back data for every hour will require additional resource effort in Transco's 24-hour control room. Furthermore, such data processing will be necessary even if only one bid is present or Transco does not intend to take a buy back action; Transco does not consider this to be the most efficient utilisation of its resources.

Transco has assessed the impact of having to process a regular hourly buy back auction and a regular within day firm auction and is concerned that the two auctions could not be completed within the same time period. Given the potential for conducting both auctions, at different ASEPs, then it is essential that there is flexibility in the timing and duration of the auction processes that a fixed time window would not allow.

With regard to signalling the possibility of buy backs to shippers, via ANS, Transco believes it should have discretion whether and under what circumstances it should announce its intent to take capacity action. This was a principle that was agreed as part of the Operational Guidelines Change Proposal 0019 that supported Transco discretion. Transco believes that the incentive encourages Transco to keep capacity buy back costs low and hence Transco would always want to utilise discretion in this area where that may be expected to reduce costs. If Transco believes that an announcement to the market will reduce the cost of actions, then it should have the discretion to make such announcements. If it believes that such announcements would increase costs, then it should have no obligation to make such announcements.

Therefore whilst Transco may choose to issue such a notification it should not be exposed to unnecessary commercial risks associated with having an obligation to make such an announcement.

Transco believes that the new 'top-down' regime for release of capacity (re. Modification Proposal 0481) may change the operation of the regime with far reaching implications for shippers, Transco, producers, DFOs, suppliers and end-users. Whilst the implementation of Modification Proposal 0481 may increase the likelihood of capacity buy back activity, the exact impact on the buy back market is unpredictable. Transco therefore believes that it would be premature to include prescriptive rules in the Network Code that restrict Transco's ability to effectively manage the capacity buy back process.

It is therefore Transco's opinion that this Proposal should not be implemented.

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

The proposer states that the introduction of potential buy back notification and discrete window for the buy back activity better facilitates the relevant objectives by promoting active shipper participation and greater liquidity in the 'buy back' market and thereby encouraging lower balancing costs.

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

a) implications for the operation of the System:

Transco is unaware of any such consequence.

b) development and capital cost and operating cost implications:

Transco is unaware of any such 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:

The cost of system development and testing would be met from allowed revenues for such purposes.

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

Transco is unaware of any such consequence.

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 contractual risk may be increased in that the proposal prevents Transco from revisiting the buy back market more than one time within an hour bar. This may have consequences for Transco's contractual obligations under its Network Code.

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

The necessary system change required to allow this modification to be implemented would need to be assessed should the modification be approved. Any change that coincides with the 1st October presents a further risk for both shippers and Transco.

Transco anticipates that implementation of the proposal would increase operational costs due to the potentially increased work load of simultaneously managing buy backs and within day firm capacity. There is a risk of system/data contentions should two auction processes be run at concurrent times.

7. The implications of implementing the Modification Proposal for Users

The proposer states that there is a benefit to Users in freeing up operational resources from reviewing the RGTA system on a continuous basis.

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

Restrictions on buy back activity may impact flow rates onto the system. Restrictions might generate larger flow rate changes given any delays to buy back actions.

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 unaware of any such implications.

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

Advantages :-

a. Shippers would be aware of when Transco intends to enter the buy back market hence reducing requirement for shippers to continuously monitor IT systems and this may increase liquidity.
b. Notification process would become more transparent.

Disadvantages :-

a. Transco's ability to go to the market at any time (as is currently the case) would be restricted to a 15-minute window in each hour bar.
b. Restrictive time window is inconsistent with the discretion associated with the introduction of Transco incentives to take appropriate and efficient actions
c. Issuing of a formal notification via an ANS message may highlight Transco to be a distressed buyer and may adversely affect shipper bidding behaviour, thus leading to an increase (rather than reduction) in buy back costs.
d. The market maker process could be compromised by the introduction of a fixed time window for buy back actions and therefore prevent firm capacity being utilised by users who require it

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 eight shippers:

Northern Electric & Gas Limited (NEAGL)
Innogy
Powergen
BP Gas Marketing Limited (BP)
Conoco (UK) Limited (Conoco)
TotalFinaElf Gas and Power Limited (TFE)
Scottish and Southern Energy (SSE)
British Gas Trading (BGT)

Four respondents supported the Proposal as it stands. One respondent supported the Proposal but suggested further refinements to the Proposal. One respondent saw merit in this Proposal but had a number of queries about its practical operation. One respondent expressed conditional support for the Proposal whilst one respondent did not support its implementation.

NEAGL believes that discrete capacity surrender periods within day may facilitate increased shipper to shipper competition and at the very least alleviate some of the administrative burden Transco and shippers face with respect to capacity management.

Innogy agrees that it is important to increase active shipper participation in the buy back market, particularly in the light of Modification Proposal 0481. It believes that introduction of a clear definition of the times that Transco may be active in this market will lead to increased shipper participation.

Powergen agrees that implementation of Modification Proposals 0481 and 0488 could lead to an increase in the buy backs. It believes that the ANS signal would allow shippers to act and bid against each other more efficiently within a discrete period, which should improve liquidity and lead to lower buy back costs. It also agrees that the Proposal would free up shipper resources as shippers would only need to concentrate on the discrete 15-minute period. With regard to the wording of the ANS signal, Powergen suggests that Transco

should state the probability of buy back action, and that this should be higher than 90%. This would ensure that Transco did not use the ANS signal too frequently. Powergen supports the Proposal on the condition that Transco does not use the ANS signal too frequently.

BP believes that the discrete window for buy backs will improve shipper participation and reduce balancing costs. It suggests that the benefits of the Proposal could be further refined by extending the 15-minute window to a 20 minute period, with a minimum notice period of 45 minutes. It also suggests that the notification should be communicated via ANS, fax and e-mail to reflect the crucial nature of this information.

Conoco believes that the Proposal would ensure that all shippers who are able to take part and place bids are doing so without the need for extra vigilance of the RGTA screens. It also states that a discrete window is necessary if shippers are required to adjust flows in response to bids being accepted, and beyond which shippers can check the status of their bids. However, Conoco would not necessarily expect Transco to fulfil all its buy back requirements within one 'action window'.

The Proposer TFE reinforces the points it raised in the Proposal and believes that it is in everyone's interest to minimise buy back and constraint management costs via a responsive and liquid capacity buy back market. It believes that the current arrangements, whereby operational staff need to constantly monitor and update buy back screens 24 hours each and every day, is neither efficient nor cost effective use of hard pressed and finite resources. TFE also believes that other operational demands may take priority over screen monitoring, with the consequential adverse impact upon shipper responses to buy back requirements, liquidity and costs. Introduction of a discrete window for buy back activity will, it believes, encourage greater shipper participation and market liquidity, and thereby lower buy back and constraint costs. TFE acknowledges that the prevailing timescales have only allowed limited scope for discussion and development of the Proposal but believes that the Proposal could be implemented by 1 October 2001 and that it represents a pragmatic and practical approach to implement measures that will improve both market response to buy back requirements and liquidity, as well as reducing buy back and constraint management costs. TFE would like to correct references to 'lowering of balancing costs' in its Proposal, and amend these to refer to the 'lowering of buy back and constraint management costs'.

SSE sees merit in this Proposal as it seeks to increase market liquidity and reduce the overall costs of alleviating system constraints. However, it has a number of queries about the practical operation of the Proposal. SSE would like clarification on whether the ANS message would indicate the volume of buy back that might be required. It also seeks assurance that there would be no adverse impact on Transco's systems if a large number of offers are posted within a limited timeframe. SSE presumes that shippers would still be able to post offers at any time, and that the main amendment would be Transco's acceptance of bids within the 15-minute window. It also presumes that the buy back bids would be processed in a similar way to that for daily capacity bids.

BGT expresses reservations regarding the benefits of notification by Transco of its intention to buy back, and introduction of a discrete window for the buy back activity. BGT comments that the Proposal suggests a mechanism similar to the buy/sell indicator adopted at the outset of the OCM but experience with respect to energy trades demonstrates that it did not improve liquidity or balancing outcomes. It also comments that shippers need to be prepared to always offer buy backs at a price they would be prepared to sell capacity back to Transco, rather than just when they are prompted to do so. BGT believes that liquidity will develop as Transco actually starts taking buy back actions and all parties experience a period of adjustment to the changes in the regime; BGT believes that this process is important if market reflective prices are to be achieved. With regard to the 15-minute window for buy back activity, BGT suggests that the fundamental requirement is for shippers and Transco to prioritise their activities within available resources, and consider interaction of buy back activity with other activities; Transco, for example, may attach higher priority to within day balancing activity within a particular 15-minute period rather than buying back capacity for the following day which could be addressed once the balancing action has been completed. More importantly, Transco should use best endeavours not to take either capacity or balancing actions in the last 20 minutes of the hour bar so that shippers could make renominations by the following hour bar. There is also a prioritisation interaction between local and national constraint management. BGT believes that, bearing in mind these interactions between various activities, restricting capacity buy backs to a short window in each hour can be expected to result in higher capacity buy back costs than would result from a 'continuous' market. The advantage of a continuous market is that Transco can take appropriate actions as they become necessary. BGT also believes that a restricted capacity trading window could adversely affect both market liquidity and volatility. BGT is concerned that the additional large volumes and the nature of buy back activity resulting from implementation of Modification Proposal 0481 will impose further limitations on the RGTA computer system, and will make a 15-minute window unworkable. BGT notes that there is confusion in the Proposal between energy and capacity issues; whilst there may be consequential effect on gas balancing costs, the Proposal is in fact about capacity constraint management and costs. BGT points out the significance of information issues and states that consideration should be given to the provision of further updates on the predicted capacities available for the following day. BGT concludes that the Proposal could adversely affect market liquidity and efficiency.

Transco's Opinion:

Transco does not agree that this proposal should be implemented. It does however, believe that under some circumstances there may be merit in issuing an advanced signal of intent to consider buy back actions via the ANS communications medium. It does not believe that communication via any other method would be appropriate given the potential time constraints that would be experienced should Transco need to accept buy back bids.

Transco agrees that communication via ANS may stimulate greater volumes of capacity to be offered and that consequently lower prices may be offered. However Transco does not believe it should have any contractual obligation to provide such notification, rather that it

should be a matter for operational discretion. Furthermore Transco should not attract any liability when it considers it inappropriate to accept buy back bids where it had indicated it would be reviewing the available bids.

Transco does not consider that such activity needs to be described in the Network Code. Transco believes that the format of such communications should be subject to evolutionary development as greater experience of capacity management is gained. Transco concurs with BGT's view that a firm obligation to provide such notification may have dubious economic benefit.

Transco agrees with the general conclusion amongst respondents that expanding entry capacity release significantly beyond physical capability in accordance with Modification Proposal 0481 may increase the risk of capacity buy backs. When the need for buy backs, or the imminent likelihood of such, has been identified then Transco should have discretion as to how and when it manages such issues.

Transco does agree that actions close to the hour bar could result in shippers not having sufficient time to notify their gas producers to affect gas flows. It therefore recommends that as part of this proposal it would normally accept buy back bids 20 minutes prior to the hour bar, and notify shippers accordingly. Again Transco believes it should attract no liability if it considers it appropriate to take action closer to the hour bar if the situation demands it.

Transco does not believe that either safe management of the pipeline system or more advantageous (lower) prices will be furthered by restricting Transco actions to a limited window of opportunity.

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 implications.

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

Transco is not in support of implementing the Modification Proposal and therefore has not developed 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. 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 in respect either the original or alterntive Modification Proposals and Transco now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

No legal text is provided as Transco is not in support of this Modification Proposal.

Date:
Signed for and on behalf of Transco.

Signature:

Tim Davis
Head of Regulation NT&T

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 **0491**, version **1.0** dated **10/09/2001**) 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 **1.0**.

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.