

Draft Modification Report
Removal of the Incentivised Nomination Tolerance Quantity
Modification Reference Number 0552

Version 1.0

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

1. The Modification Proposal

It is proposed that the Incentivised Nomination Tolerance Quantity (INTQ) is removed from the calculation of a User's Forecast Performance Measure as part of the Incentivised Nomination Scheme. The proposed change, if implemented, will effectively set the INTQ to zero.

2. Transco's Opinion

Modification Proposal 0479 "Incentivised Nomination Scheme" (INS) will be implemented from 1st October 2002. The scheme includes the Incentivised Nomination Tolerance Quantity (INTQ) that is designed to prevent User exposure to costs that might be considered to arise as a result of differences between a User's aggregate NDM nomination prevailing at each INS assessment time and its aggregate NDM allocation. Removal of the INTQ would therefore increase INS charges for Users with an NDM portfolio under some circumstances.

The INTQ was included within INS to achieve similar objectives to the NDM Forecast Deviation applied under the imbalance cash-out arrangements. Ofgem stated in its decision letter for Modification Proposal 0479 that Transco should consider carefully whether the INTQ should continue to apply given Ofgem's decision to direct Transco to remove the NDM Forecast Deviation as a result of Modification Proposal 0511. Transco therefore raised this Proposal to facilitate debate and consultation as to whether the INTQ should continue to apply within the regime.

As part of Workstream development of this Proposal, it was considered that, if the concept of the INTQ should be retained, alternative approaches to provide Users an appropriate level of protection to NDM nomination versus allocation variances might be worthy of consideration. Such approaches might include the setting of a revised allowance at a fixed absolute size (perhaps related to minimum size of regular gas trades), or rounding of derived quantities that attract charges under INS.

Transco therefore seeks respondents views as to: -

- whether the concept of the INTQ should be retained; and
- if the concept of the INTQ is retained, whether alternative methodologies by which within day NDM forecasting inaccuracies are accommodated under INS could be formulated to better facilitate the relevant objectives than the approach advocated with Modification Proposal 0479. Transco specifically seeks views as to the appropriateness and the basis for

any proposed fixed absolute quantity, and the methodology by which rounding could be applied in the INS charge determination process.

The incentive properties of INS are designed to encourage Users to provide their best possible projection of their end of day imbalance to Transco throughout the balancing period. A User is likely to take into consideration its forecast NDM demand for the gas day in determination of its imbalance projection. This forecast could be its NDM nomination provided by Transco or its own NDM forecast. If the NDM demand forecast changed after the first INS assessment time of 02:00 ahead of the gas day, the User would obtain the greatest benefit from the scheme if it maintained its projected imbalance and tracked the forecast demand change.

The removal of the INTQ would increase incentives on Users to provide accurate imbalance projections. It might therefore be argued that this Proposal would result in better User balancing performance, provided that Users can achieve better forecasts of its NDM demand than produced by the demand attribution process. This Proposal might therefore improve operation of the system. Transco would, however, welcome views from respondents as to whether this Proposal would better facilitate the economic and efficient operation of the system.

In addition, Transco recognises the potential for increased risk exposure on Users with an NDM portfolio as a result of this Proposal, particularly those Users that are particularly susceptible to NDM demand forecast difficulties. Transco would therefore welcome views from respondents as to whether this Proposal would better facilitate competition between relevant Users.

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

Removal of the INTQ will result in full exposure of any difference between a User's projected imbalance and its allocated imbalance to the relevant SMP - SAP differential. It may be argued that if a User is able to respond to the increased incentive by developing models that result in a more accurate NDM demand forecast for its portfolio than that provided by Transco, then the User's projected imbalance would be more accurate. As a User's projected imbalance will be used to inform Transco's balancing action decision making process, any improvement in its accuracy may result in an improvement in the efficiency of balancing actions. Therefore the Proposal might further the relevant objective of "efficient and economic operation" as stated in Standard Condition 9 1 (a).

Additionally, the increased risk exposure faced by Users that are particularly susceptible to NDM demand forecasting difficulties may generate additional risk mitigation costs and changes to the redistributive effects of the Balancing Neutrality process. To the extent that such changes do not impose inappropriate costs, the Proposal may be consistent with facilitating competition between relevant Users, as stated in Standard Condition 9 1 (b).

**4. The implications for Transco of implementing the Modification Proposal , including
a) implications for the operation of the System:**

Removal of the INTQ will result in full exposure of any difference between a User's imbalance forecast and its projected imbalance to the relevant SMP - SAP differential. If a User is able to respond to the increased exposure by improving the accuracy of its projected end of day imbalance, the accuracy of Transco's forecast system balancing requirements might also be improved.

However, it is also recognised that there is the potential for adverse impacts as a result of User's attempting to mitigate the increased risk exposure.

b) development and capital cost and operating cost implications:

The INS system has been developed such that the INTQ can be included or excluded from the INS charge determination algorithm with 2 days notice without incurring any additional costs.

However if alternative methodologies to provide allowance for NDM forecasting inaccuracies are to be developed, additional capital cost might 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:

If the INTQ is removed, there will be no additional costs to recover above those for the INS system developed for Modification Proposal 0479.

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

This Proposal is not considered to have consequences in respect of 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

No such consequences are anticipated.

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

No such consequences are anticipated.

7. The implications of implementing the Modification Proposal for Users

Transco considers that Users with an NDM portfolio would be exposed to increased INS charges under some circumstances. This would result in increased INS credits redistribution through Balancing Neutrality and therefore reduced net charges, or increased

net reward, for Users without an NDM portfolio and those Users with an NDM portfolio that develop improvements in the accuracy of their NDM forecast above that of other Users.

In addition, Transco considers that Users would need to decide whether to accept the risk, invest in better forecasting systems or seek to procure better risk management tools from other providers.

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

Transco considers that there would be no direct impact on the above parties.

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 changes to contractual relationships are anticipated.

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

Advantages:

- Increased incentives on Users with an NDM portfolio to provide Transco with their best possible projected end of day imbalance position.
- Any improvement in a User's projected end of day imbalance may improve the efficiency of Transco balancing actions.
- May promote the development of new NDM forecasting models and risk management tools.
- Simpler INS charge determination and verification.

Disadvantages:

- NDM demand changes within day can be difficult to predict and may be outside of User control, thereby exposing Users to inappropriate risk.
- Exposing Users to increased INS charges for inaccuracies in their INS nomination information could disproportionately affect those Users who are particularly susceptible to NDM demand forecasting difficulties. This may be particularly true of small Users with a predominantly NDM portfolio.
- To compensate for the increased exposure, charges for NDM customers may increase.
- The increased risk exposure may deter potential new entrants to the NDM market.
- There may be adverse changes in User behaviour as a result of Users attempting to mitigate the increased risk exposure.
- May remove incentive for Users to track NDM nomination changes which may decrease operational efficiencies.

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

To be completed following the consultation period.

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 enable Transco 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

Not applicable.

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

If this proposal is implemented, the INTQ would be removed by changing a setup parameter in the INS system.

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

The proposed timetable is as follows:

Modification Panel decision ("to consultation")	18/07/02
Draft Modification Report published	23/07/02
Industry consultations close out	13/08/02
Final Modification Report published	23/08/02
Anticipated Ofgem decision	13/09/02
System changes live (subject to above)	28/09/02
Implementation date (subject to above)	01/10/02

16. Recommendation concerning the implementation of the Modification Proposal

Transco will make its recommendation based on representations it receives as part of the consultation on this Proposal in the Final Modification Report.

17. Text

SECTION E: DAILY QUANTITIES, IMBALANCE AND RECONCILIATION

Amend paragraph 5.3.8 (a) to read as follows:

- (a) a User's "**Forecast Performance Measure**" at a Forecast Daily Imbalance Time in respect of a Day shall be calculated as follows:

$$FPM_t = \text{abs} (N_t - A)$$

where:

FPM_t is the Forecast Performance Measure at Forecast Daily Imbalance Time 't';

N_t is the User's Prevailing Forecast Daily Imbalance at Forecast Daily Imbalance Time 't';

A is the User's Daily Imbalance in respect of the Day; and

Delete paragraph 5.3.8 (c)

Rename paragraph 5.3.8(d) as paragraph 5.3.8(c)

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

Signed for and on behalf of Transco.

Signature:

Tim Davis
Head of Regulation NT&T

Date: