TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0575

"Revisions to cash out pricing and the methodology for recovery of OM costs"
Version 1.0

Date: 07/08/2002

Proposed Implementation Date: 01/10/2002

Urgency: Non-Urgent

Justification

Under the current Code rules and transportation charging methodology, OM storage capacity costs are recovered through the SO commodity charge. All other costs are recovered through the balancing neutrality mechanism. As a result, all OM costs are recovered from the whole market with no targeting of the costs to different users who cause them to be incurred.

Such a treatment of the costs would be reasonable and cost-reflective if all OM holdings and all use of OM were for "system" purposes to the benefit of all system users equally. In Transco's OM report, published each year, Transco states that it holds OM against the following events:

(i) beach supply failure;
(ii) late within day change in forecast demand;
(iii) NTS compressor failure; and
(iv) NTS pipeline failure.

Arguably, costs associated with holding and/or using OM gas for the first two categories should be targeted to the users who cause them to be incurred.

In addition, this winter operations review suggests that Transco are also, in extremis, using OMs as a gas balancing tool of last resort. Transco have suggested that on 2 January this year (the highest ever throughput on the NTS), they had exhausted all available supplies at the beach and had to resort to OM, withdrawing about 800,000 therms from Avonmouth and Isle of Grain.

Where OMs are used for gas balancing, the costs should be fed into daily cash-out prices. Recovering costs from all users leads to a significant cross-subsidy between shippers who are in balance (or long) and those shippers who are short on peak days. The current arrangements also send inappropriate price signals of the risk and costs imposed on the system by shippers who are short on peak days. The current arrangements artificially dampen imbalance prices on peak days.

Nature of Proposal

The current OM cost recovery mechanism should be amended to improve cost targeting and provide better incentives to shippers to balance their inputs and offtakes, pariticularly on days of peak demand.

Criteria should be set out in the Code to determine whether Transco's use of OM gas is for "system" or "gas balancing" purposes. Transco would then use these criteria to "tag" OM use as either system or gas balancing actions.

Where OM gas is withdrawn for gas balancing purposes, the full costs of OM (including storage capacity costs, commodity costs, injection and withdrawal costs, financing costs, NTS transportation costs) should be included in the calculation of cash out prices for that gas day. The use of OMs should be deemed to be a market balancing action and the price (based on the full costs outlined above) should be deemed to be an accepted market offer for the purposes of calculating the system marginal buy price for that Gas Day.

Where OM gas is withdrawn for system balancing purposes, the recovery of costs should continue to be made under existing Code arrangements.

Purpose of Proposal

This modification would better facilitate the relevant objectives of the efficient discharge by Transco of its obligations under its licence, the economic and efficient operation of the pipeline system. It would also facilitate competition between shippers and suppliers by unwinding any cross subsidies. Finally, by improving cost targeting, particularly on peak days, the proposal would better facilitate the objective of providing reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply " Domestic Customers) of the standard conditions of Gas Suppliers" licences) are satisfied as respects the availability of gas to their domestic customers.

Consequence of not making this change

Maintaining the current arrangements for recovery of OM costs will distort incentives on shippers to forward contract to ensure that peak demands can be met. The resulting cross-subsidies between users will distort competition.

In extreme circumstances, inappropriate price signals on peak days could increase the risk of firm load shedding and a network supply emergency.

Area of Network Code Concerned

Section K

Proposer's Representative

Stephen Charles Smith

Proposer

Aep Energy Services Ltd

Signature

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