TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0606

"Reform of the cash out arrangements and the inclusion of costs of OM gas used for end of day balancing purposes using a stack process"
Version 1.0

Date: 17/12/2002

Proposed Implementation Date:

Urgency: Non-Urgent

Justification

This modification (and the related modification number xxx) has been raised following discussions in workstream meetings and the development of business rules for modification proposal 575, "Revisions to cash out pricing and the methodology for recovery of OM costs".

The two modifications represent two distinct approaches, arising from the Modification Proposal 0575 development process. Modification Proposal 0575 proposed that Transco use the full costs of any OM gas utilisation (reflecting storage space, gas, injection and withdrawal costs) to derive a unit cost that might feed into the cash out price determination process where Transco has used OM gas for end of day balancing purposes. Following workstream discussions, it was agreed that the development process had led to two different approaches that were sufficiently different from the original proposal to merit consideration as two separate Modification Proposals. Detailed business rules have been produced by the workstream as part of the Modification Proposal 0575 development process for each alternative proposal. These rules are contained within version 3.0 of the Modification Proposal 0575 rules [that have been circulated to the industry}

Under the current Code rules and transportation charging methodology, OM storage capacity costs are recovered through the SO commodity charge. All other OM costs are recovered either via the Daily Margins Recovery Amount used in the determination of Balancing Neutrality Charges or via the Closing Margins Adjustment Charge. 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.

Costs associated with using OM gas for the first two categories should, where it is practical to do so, be targeted to the users who cause them to be incurred. Where OMs are used for end of day balancing purposes, then both the size and an estimate of the unit price of such action should contribute to the determination of cash-out prices.

Recovering costs from all users may lead 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 may 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 could also artificially dampen imbalance prices on peak days where OM gas is used to correct an end of day imbalance.

This proposal would lead to changes in the way that cash out prices are determined, even on non-peak days. The proposal could lead to a greater use of default cash out prices compared with the current rules.

This proposal could also lead to significantly higher cash out prices on peak days where OM gas is used for end of day balancing purposes than under the current rules. The proposal would not, however, place any restriction or cap on cash out prices. Where Transco took other balancing actions in addition to OM usage at higher prices, these higher priced market actions would still be used to determine cash out prices.

Nature of Proposal

The current rules used to determine cash out prices would be replaced. Under this proposal, Transco would create an accepted buy (sell) stack in ascending (descending) price order of all balancing actions,. Transco would also calculate an OM unit cost (in p/KWh) and publish these costs in accordance with rules set out in the Network Code. Any OM actions would be included in the buy stack at this OM unit cost and with a quantity associated with the OM transaction.

Where Transco was a net buyer over the day, the volumes of any sells would be used to remove an equivalent volume of the highest priced buys from the buy stack. Where Transco was a net seller over the day, the volume of any buys would be used to remove an equivalent volume of the lowest price sells from the sell stack.

Transco would then use the remaining price stack to determine cash out prices subject to the current differentials between SMP buy and SMP sell. Transco would determine a ‘Net System Imbalance’ for the Gas Day. This would comprise the difference between aggregate user inputs and offtakes net of any sales/purchases to/from Transco. This volume would then be used to determine the relevant price from either the buy or sell stack to set either SMP buy and/or sell. Where the price from the stack was below (above) the current fixed differentials, cash out prices would continue to be set using these differentials.

Where Transco does not take an action or where Transco’s balancing action are in the same direction as the NSI (either the community are "long" and the System has been buying or the community are "short" and the System has been selling) then cash-out prices will be determined as SAP +/- the relevant minimal price differential.

The above reflects "option 2" of the version 3.0 business rules developed as part of the Modification Proposal 0575 process.

Purpose of Proposal

This modification would better facilitate the relevant objectives of the efficient discharge by Transco of its obligations under its licence in respect of the economic and efficient operation of the pipeline system. It would also facilitate competition between shippers and suppliers by reducing the potential for cross subsidies. By improving cost reflectivity, 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 may distort incentives on shippers to forward contract to ensure that peak demands can be met. The resulting cross-subsidies between users may 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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