

## **TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0607**

"Change to the cash-out arrangements where Transco defines Operating Margins (OM) gas usage for end of day balancing purposes"

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 be targeted to the users who cause them to be incurred. Where OMs are used for end of day balancing purposes, the costs should be used in determining 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 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 could, compared with the existing rules, lead to significantly higher cash out prices on days where OM gas is used for end of day balancing purposes. 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**

Transco would calculate an OM unit cost (in p/KWh) and publish these costs in accordance with rules set out in the Network Code. When OM gas was used, Transco would determine at the time whether the OM gas was used for system balancing (i.e. within day balancing and/or NTS constraints/compressor failure) or end of day balancing purposes. Where Transco determined that OM gas was used for end of day balancing purposes, the OM unit cost would be included in the calculation of SMP cash out prices as if it had been an action taken on the OCM. If the OM unit cost was above the highest priced balancing action taken by Transco for that day, the OM unit rate would be used in the determination of the System Marginal Buy Price (via revision of F 1.2.1 (i) (b) ). Similarly if the OM unit cost was the lowest priced balancing action taken by Transco for that day then it would be used in the determination of the System Marginal Sell Price (via revision to F 1.2.1 (ii) (b) ) This Proposal does not advocate amending the basis for the calculation for the System Average Price. If the OM unit cost was below the highest prices balancing action taken by Transco for that Day, the System Marginal Buy Price would be the highest priced action on the OCM.

## **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 existing 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. Any 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**

0607 : Change to the cash-out arrangements where Transco defines Operating Margins (OM) gas usage for end of day balancing purposes v1.0

Aep Energy Services Ltd

**Signature**

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