Draft Modification Report
Alignment with Transco Licence Changes Relating to the Treatment of the Costs of Locational Actions in Transco's SO Incentive Schemes
Modification Reference Number 0687

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

In order to align the Network Code with the changes proposed for Transco's GT Licence, it is necessary to remove Locational Actions (as to be defined in the Licence) from Balancing Neutrality and include them in Capacity Neutrality, as well as to address associated invoicing arrangements. Similarly, it is necessary to remove Physical Renomination Incentive Charges from Balancing Neutrality and include them in Capacity Neutrality.

Transco believes that the following areas will need to be addressed in aligning the Network Code with the proposed changes to Transco's GT Licence:

1. Remove Locational Actions from Balancing Neutrality;
2. Add Locational Actions to Capacity Neutrality;
3. Remove Physical Renomination Incentive Charges from Balancing Neutrality;
4. Add Physical Renomination Incentive Charges to Capacity Neutrality; and
5. Make associated changes to energy and capacity invoicing arrangements.

This Modification Proposal has been developed to remove inconsistencies in the treatment of revenue streams that would otherwise arise between the Network Code and the proposed changes to Transco's GT Licence as notified under Section 23(3) of the Gas Act on 3rd March 2004.

2. Transco's Opinion

On 3rd March 2004 Ofgem made a direction under Section 23(3) of the Gas Act 1986 that changes should be made to Transco's GT Licence with effect from 1st April 2004 (Transco NTS SO Incentives 2004-2007: Licence Modifications – Shallow Incentives). Ofgem subsequently published a letter on 23rd March identifying and correcting a number of minor errors in the Section 23(3) notice. Transco has consented to the modification of its GT Licence in the manner specified in the Section 23(3) notice, as subsequently amended.

Under the modified Licence the Entry Capacity Buy Back Incentive will now include the costs and revenues resulting from locational energy actions and Physical Renomination Incentive (PRI) Charges on the premise that locational energy actions are substitutable for entry capacity buy back actions. In addition to the Licence change, Ofgem has made it clear to Transco that the above costs and revenues should be apportioned in line with Users' entry capacity holdings. It is intended therefore to allocate the costs and revenues resulting from

locational energy actions and PRI Charges on the same basis as entry capacity buy back costs, i.e. on end-of-day firm entry capacity holding rather than on energy throughput.

The revised GT Licence also includes a new term, 'Locational Actions', which is defined as:

> "any action taken by the licensee where the action was taken in respect of a specific location and would therefore be coded with a locational reason code on the OCM. Locational buys will be treated as a cost to the licensee and locational sells will be treated as a revenue."

Transco is of the opinion that the changes to the Network Code necessary to reflect the Licence changes include:

- The removal of the costs and revenues resulting from Locational Actions from Energy Balancing Neutrality by amending the calculations of Aggregate System Receipts and Aggregate System Payments to exclude Locational Actions.

- The inclusion of the costs and revenues resulting from Locational Actions in Entry Capacity Neutrality by amending the calculations of Relevant Capacity Revenues and Relevant Capacity Costs to include Locational Actions.

- The removal of revenues resulting from PRI Charges from Energy Balancing Neutrality by amending the calculation of Aggregate System Receipts to exclude PRI Charges.

- The inclusion of revenues resulting from PRI Charges into Entry Capacity Neutrality by amending the calculation of Relevant Capacity Revenues to include PRI Charges.

To facilitate early implementation of this Proposal, to move the redistribution of costs and revenues associated with Locational Actions and PRI Charges from the Energy Balancing (EBI) invoice to the NTS Entry Capacity (NTE) invoice, Transco envisages that invoicing and payment arrangements between Transco and the Market Operator will remain unchanged. Accounting processes internal to Transco will ensure that PRI Charges and payments from/to the Market Operator in relation to Locational Actions are included in the appropriate Neutrality revenue pots.

It may not be possible to include all potential Locational Actions in the NTS Entry Capacity Invoice produced at M+4, due to the timing of related data transfers. Consequently, it is proposed that the Neutrality elements of Locational Actions will be invoiced two months in arrears. However, Transco will continue to settle accounts with the Market Operator for the Locational Actions to the current timescales.

Transco recommends implementation of the Proposal.

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

In its explanatory notes accompanying the Section 23(3) notice referred to in section 2 above, Ofgem considered that the Licence proposals would incentivise Transco "to make more efficient decisions when deciding which balancing tool to use, which would in turn allow Transco to more efficiently incur balancing costs". In Ofgem's opinion, it would therefore better facilitate the relevant objective of efficient discharge of Transco's obligations under its Licence, as stated in paragraph 1 of Standard Condition 9.

Implementation of the Proposal would ensure that the costs and revenues associated with Transco Locational Actions and PRI Charges are apportioned on the same basis as entry capacity costs and revenues. It may also be considered that it would also therefore better facilitate the relevant objective of efficient discharge of Transco's obligations under its Licence, as stated in paragraph 1 of Special Condition 29.

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

a) implications for the operation of the System:

It is not considered that implementation of the Proposal would have any material adverse impact on the operation of the system.

b) development and capital cost and operating cost implications:

Transco is currently conducting an impact analysis of the Proposal in regard to invoicing processes. This analysis needs to be completed before the development, capital and operating cost implications can be fully understood.

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:

Any costs associated with increased operating expenditure and/or system development would be considered under the internal costs incentive.

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

No such consequences are envisaged.

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 envisaged.

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

Transco is currently conducting an impact analysis of the Proposal in regard to invoicing processes. This analysis needs to be completed before the development, capital and operating cost implications can be fully understood.

However, it is anticipated that additional revenue share flags will be needed for the Capacity Neutrality invoice.

7. The implications of implementing the Modification Proposal for Users

The costs and revenues of Locational Actions and PRI Charges will be apportioned in line with Users' end-of-day firm entry capacity holding rather than on their energy throughput.

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

No such implications are anticipated.

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 such implications are anticipated.

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

Advantage:

In its explanatory notes accompanying the Section 23(3) notice referred to in section 2 above, Ofgem considered that the Licence proposals would incentivise Transco "to make more efficient decisions when deciding which balancing tool to use, which would in turn allow Transco to more efficiently incur balancing costs".

Disadvantage:

Transco has previously stated that Locational Actions are not currently used interchangeably with capacity actions. As such, it may be considered as inappropriate that the costs of such actions are targeted on the basis of entry capacity holdings.

Implementation timescales require a manual workaround in the short term to reallocate the costs and revenues associated with Locational Actions and PRI Charges. This will also have an impact on resources required, administration processes and will increase the risk of errors occurring until automated processes can be put in place.

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

Representations are now sought for the Proposal.

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation

This Proposal is not required 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

No such requirement exists in respect of this Modification Proposal.

14. Programme of works required as a consequence of implementing the ModificationProposal

An implementation timetable will be developed following consideration of Representations received and completion of the impact analysis referred to in section 4b above.

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

An implementation timetable will be developed following consideration of Representations received and completion of the impact analysis referred to in section 4b above.

16. Recommendation concerning the implementation of the Modification Proposal

17. Text

Section B

Amend paragraph 2.13.2 to read as follows:-

"(a) "**Relevant Capacity Revenues**" are the aggregate of the amounts payable to Transco by Users:

(i) by way of Capacity Charges in respect of:

(1) ……;

(2) ……; and

(3) ……,

at the Aggregate System Entry Point;

(ii) by way of System Entry Overrun Charges; and

(iii) where any User has…….paragraph 5.5.2(b)~~,~~; and

(iv) by way of Market Balancing Action Charges in respect of each Market Balancing Sell Action (or negatively priced Market Balancing Buy Action) taken for that Day as a result of a Localised Transportation Deficit and/or a Transportation Constraint; and

(v) by way of any other amounts payable to Transco in respect of Eligible Balancing Actions taken pursuant to Contingency Balancing Arrangements as a result of a Localised Transportation Deficit and/or a Transportation Constraint; and

(vi) by way of Physical Renomination Incentive Charges,

in respect of such Day;

(b) "**Relevant Capacity Costs**" are the aggregate of the amounts payable by Transco to Users by way of:

(i) Capacity Management Charges……..; and

(ii) Aggregate Constraint Amounts pursuant to Section I3.7.2,

in relation to the Aggregate System Entry Point in respect of such Day;~~.~~

(iii) Market Balancing Action Charges in respect of each Market Balancing Buy Action (or negatively priced Market Balancing Sell Action) taken for that Day as a result of a Localised Transportation Deficit and/or a Transportation Constraint; and

(iv) any other amounts in respect of Eligible Balancing Actions taken pursuant to Contingency Balancing Arrangements as a result of a Localised Transportation Deficit and/or a Transportation Constraint."

Section F

Amend paragraph 4.4.2(a) to read as follows:-

"(a) the Market Balancing Action Charges payable to Transco in respect of each Market Balancing Sell Action (or negatively priced Market Balancing Buy Action) taken for that Day (other than any Market Balancing Sell Action (or negatively priced Market Balancing Buy Action) taken for that Day as a result of a Localised Transportation Deficit and/or a Transportation Constraint) and any other amounts payable to Transco in respect of Eligible Balancing Actions taken pursuant to Contingency Balancing Arrangements (other than as a result of a Localised Transportation Deficit and/or a Transportation Constraint) in respect of such Day;"

Delete paragraph 4.4.2(d) and amend paragraph 4.4.2(e) to be paragraph 4.4.2(d)

Amend paragraph 4.4.3(a) to read as follows:-

"(a) the Market Balancing Action Charges payable by Transco in respect of each Market Balancing Buy Action (or negatively priced Market Balancing Sell Action) taken for that Day (other than any Market Balancing Buy Action (or negatively priced Market Balancing Sell Action) taken for that Day as a result

of a Localised Transportation Deficit and/or a Transportation Constraint) and any other amounts payable by Transco in respect of Eligible Balancing Actions taken pursuant to Contingency Balancing Arrangements (other than as a result of a Localised Transportation Deficit and/or a Transportation Constraint) in respect of such Day;"

Amend paragraph 4.5.3(a)(ii) to read as follows:-

"(ii) the amount of any Market Balancing Action Charges (other than Market Balancing Action Charges in relation to any Market Balancing Action taken as a result of a Localised Transportation Deficit and/or a Transportation Constraint), other amounts payable in respect of Eligible Balancing Actions taken pursuant to Contingency Balancing Arrangements (other than as a result of a Localised Transportation Deficit and/or a Transportation Constraint), Total Incentivised Nomination Charges….."

Amend paragraph 4.5.3(b)(ii) to read as follows:-

"(ii) the amount of any Market Balancing Action Charges (other than Market Balancing Action Charges in relation to any Market Balancing Action taken as a result of a Localised Transportation Deficit and/or a Transportation Constraint), other amounts payable in respect of Eligible Balancing Actions taken pursuant to Contingency Balancing Arrangements (other than as a result of a Localised Transportation Deficit and/or a Transportation Constraint), Total Incentivised Nomination Charges….."

Amend paragraph 4.5.3(b)(iii) to read as follows:-

"(iii) the amount of any interest paid (in accordance with Section S4.3.2) by any User to Transco on any Day in month m by virtue of the late payment of Market Balancing Action Charges (other than Market Balancing Action Charges in relation to any Market Balancing Action taken as a result of a Localised Transportation Deficit and/or a Transportation Constraint), other amounts payable in respect of Eligible Balancing Actions taken pursuant to Contingency Balancing Arrangements (other than as a result of a Localised Transportation Deficit and/or a Transportation Constraint), Total Incentivised Nomination Charges….."

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:

Mike Calviou
Commercial Frameworks Manager
NT & T

Date: