

Draft Modification Report
Revision to entry capacity overrun charges
Modification Reference Number 0653

Version 3.0

This Draft Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

The Proposer stated that :

"The current entry capacity overrun charges should be changed to safeguard Users from excessively penal overrun charges caused by an erroneous bid being accepted in the AMSEC, RMSEC and DSEC auctions. In order to maintain transparency and simplicity the highest price from each of the firm capacity auctions (LTSEC, AMSEC, RMSEC and DSEC) should be averaged and then multiplied by a factor of 8, thereby "smoothing" out the effect of any erroneous bids accepted in any of the firm capacity auctions."

2. Transco's Opinion

Transco does not support this Proposal. It recognises that the issue of determining an appropriate level of entry overrun charges has periodically been the subject of debate. It is acknowledged that the level of overrun charge on any day needs to maintain an appropriate incentive on shippers to pre-book capacity to allow Transco to operate its pipeline system in an efficient manner.

Network Code Modification Proposal 0500 (Long Term Entry Capacity Allocation) which was implemented in October 2002 amended the daily product overrun marginal component from an "average price" basis to a "marginal price" basis, while retaining the multiplier at 8. Analysis of overrun charges since the implementation of Modification Proposal 0500 (Long Term Capacity Allocation) indicates an increase in both the overrun charges and overrun quantities suggesting a change to marginal prices has not significantly increased incentives on Users to pre-back entry capacity. Transco is concerned that any reduction in the overrun multiplier may reduce the effectiveness of the overrun mechanism thus further increasing the propensity for breaches of entry capacity.

Transco recognises that acceptance of a single high priced bid could set an overrun price and that the high priced bid could have been offered either because it is reflective of a shipper's value for entry capacity or a bid is submitted in error. It is the latter example that provides a case for averaging. Transco considers that this proposition fails to address how the relative weighting between AMSEC, RMSEC and DSEC is determined and also does not take into account the impacts of having relatively low reserve prices for DSEC. For example, should DSEC have an equal weighting with AMSEC and RMSEC despite a tendency to release very low volumes in DSEC auctions. Furthermore, Transco is concerned that the proposed overrun would give an equal weighting to DSEC despite it having a considerably lower reserve price.

Transco has been provided with a preliminary indication that Transco's Entry Capacity Management system could not be modified to accommodate the Proposal before the proposed implementation date of 1 April 2004. A further estimate of systems costs and implementation timescales is anticipated in the near future.

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

In Transco's view, implementation could lead to a disincentive on shippers to pre-book entry capacity, which could impair Transco's ability to manage gas flows at entry via its capacity management tools, thus impeding the efficient and economic operation of the pipeline system.

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

The proposal could lead to a reduction in overrun charges which could lead to an increase in the likelihood of entry gas flows exceeding the aggregate capacity holdings. This could result in an increase in the use of TFA's (Transportation Flow Advice) at affected ASEPs.

b) development and capital cost and operating cost implications:

Implementation would be expected to lead to systems development costs, although a full cost estimate is not yet available.

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:

The development costs would be part-funded by the SO licence incentive.

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

No consequences are anticipated.

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 consequences are anticipated.

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

The proposal to amend the overrun component relating to firm capacity auctions from a “marginal price” to an “average price” requires new functionality within Transco’s systems, where the overrun multipliers are held and the calculation of overrun prices is processed. It is unlikely that introducing further changes to the Gemini system soon into the early stages of its implementation would be achievable by the proposed implementation date.

7. The implications of implementing the Modification Proposal for Users

Users will be exposed to a lower level of overrun charge which could lead to an increased use of TFAs to manage the system.

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

Due to a reduction in the incentive on Users to restrict their entry gas flows to their entry capacity entitlements, Terminal Operators may see an increase in the use of TFAs by Transco.

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 consequences are anticipated.

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

Advantages :

Basing overrun prices on an average of all auction types, as opposed to a marginal basis would be expected to avoid any price spikes arising from a single auction.

Disadvantages :

The ticket to ride principle may be undermined.

A reduction in the level of overrun charges could lead to an increase in the use of TFAs by Transco.

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 as part of the consultation of the Draft Modification Report.

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

No such requirement is envisaged.

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

As no changes to UK Link are envisaged, a Programme of works is not required.

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

An implementation timetable is being prepared. At this stage implementation would be expected to be later than 1 April 2004.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not support implementation of the Proposal.

17. Text

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: