TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0594

"Obligation on the shrinkage provider to acquire system entry capacity"
Version 1.0

Date: 18/10/2002

Proposed Implementation Date:

Urgency: Non-Urgent

Justification

Under current Network Code rules, the Shrinkage Provider is not required to apply or hold System Capacity or to pay capacity charges. NTS shrinkage, or own use of gas comprises four elements: unaccounted for energy, unbilled energy, system own use and fuel for electric compressors.

Transco has an incentive under its SO incentive schemes to manage NTS shrinkage costs efficiently. A separate incentive relating to LDZ shrinkage forms part of Transco's LDZ price controls. Customers pay the costs of shrinkage ultimately.

The current Network Code arrangements are inefficient and are inconsistent with Transco's licence obligation to operate an economic and efficient pipeline system and they distort Transco's incentives.

Under Transco's NTS SO incentive, Transco is set a volume target for the year and a target price to acquire shrinkage gas. The volume target for this formula year is 8,265GWh. The price target is 0.702p/kWh. Ofgem set this price target by applying a swing premium to the forward price at that time.

The shrinkage provider should, therefore, be required to hold system entry capacity and pay entry capacity (and if appropriate overrun charges) where appropriate. As the price was set on the basis of forward prices at the NBP (and not at the beach), it would have included an allowance associated with entry capacity costs. The reference price and existing incentive scheme therefore contains an allowance associated with entry capacity costs.

If Transco does not pay entry capacity costs, it will lead to payments under the incentive scheme that are not associated with efficiently procuring gas as Shrinkage Provider. It could also distort Transco's incentives to operate efficiently. Transco, when procuring shrinkage gas and utilizing existing contracts to procure gas, should face the total cost (including entry capacity costs).

This proposal merits urgent status. Transco will already have accrued 6 months of benefit under its SO incentive scheme because of an anomaly in the Network Code rules. Shippers need to be assured that Transco will, in managing shrinkage, have incentives to operate efficiently this winter. Annual shrinkage volumes for the current formula year are 8.2TWh and target costs are £60m. The value of the benefit of free capacity to Transco could, therefore, be very significant. The potential distortions and costs to shippers and customers associated with Transco bringing on gas for shrinkage purposes at constrained terminals (as

Transco does not face the costs of entry capacity and may not, under the buy back incentive, be fully exposed to any resulting buy back costs) could also be significant. As the benefits are accruing daily, and the costs could escalate rapidly during a period of entry constraints, AEP believes that this proposal merits urgent status.

Although MSEC has already been sold this winter, Transco can purchase entry capacity for shrinkage purposes in secondary markets and/or RMSEC, DSEC and Interruptible auctions.

Nature of Proposal

The Shrinkage Provider shall be required to hold System Entry Capacity and to pay all Entry Capacity Charges (and overruns) where it purchases gas for delivery to the System.

Purpose of Proposal

This modification would, if implemented, better facilitate the relevant objectives of the efficient and economic operation of the pipeline system. Transco would face the full costs (commodity and capacity) associated with procuring shrinkage gas. This will lead to more efficient system operation.

Consequence of not making this change

Transco would continue to have a strong incentive for inefficient system operation. This would lead to payments from shippers to Transco under the incentive scheme not related to improved performance. This could also lead to higher constraint costs that would ultimately be paid for by shippers and customers.

Area of Network Code Concerned

Section N

Proposer's Representative

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Proposer

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Signature

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