

Draft Modification Report
Facilitation of Shrinkage Provider to make NBP Trade Disposals
Modification Reference Number 0579

Version 2.0

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

The Shrinkage Provider is currently prohibited from making Disposing Trade Nominations.

The restriction on making Disposing Trade Nominations should be relaxed to allow the Shrinkage Provider to make Disposing Trade Nominations up to a limit of the aggregate quantities associated with Acquiring Trade Nominations for the gas day.

The relaxing of the Disposing Trade Nomination restriction will allow the Shrinkage Provider greater opportunity to more efficiently manage its account by having access to the NBP market in a manner closer to that of other market participants.

2. Transco's Opinion

Transco has recently made changes in the way that it procures gas for the Shrinkage Provider (SP) account. The financial benefits from this change will be shared with Users through operation of the SO incentive schemes specified in Transco's Gas Transporters Licence.

The Network Code does not permit the SP to make NBP trade disposals. Given that the NBP is the focus of most prompt market trading activity this restricts the ability of the SP to manage imbalance exposure thereby potentially increasing costs for Transco and Users in general. Removing the restriction would better enable SP risk management activity and would overcome the currently perceived weakness that the SP Network Code rules encourage the SP account to be nominated "short" with prompt market procurement used to get close to balance very close to, or during the gas flow period. Although unproven, Transco also notes the concerns expressed by some market participants that any such bias might also increase the risk of upward pressures on prompt prices with consequent impact on the forward curve.

The SP account is not liable for transportation charges. This has been a feature of the SP arrangements since the start of the Network Code and Transco believes this was taken into account in the setting of the last two price controls. Therefore, to preserve the assumptions that underpin the SO incentives Transco believes that it would be inappropriate for the SP to accept gas at the beach in excess of that required to balance the SP account but then subsequently sell any such excess gas at the NBP. To address this the legal text supporting this Proposal includes a restriction such that the quantity of gas which is the subject of disposing NBP trades, must be less than, or equal to, the quantity associated with NBP trade acquisitions for that Gas Day.

During the development of this Proposal it was suggested that Transco should be required to make additional information available in respect of the operation of the account where it is

involved in NBP Trade disposals in excess of a threshold. It was suggested that such a threshold might be set as a % of the daily shrinkage quantities taking account of the likely uncertainties of shrinkage quantities such that the approach might trigger reporting on an occasional basis.

Transco's initial view is that such reporting is unnecessary and would impose an inappropriate burden and risk on both Users and Transco. The SO incentives provide strong financial incentives on Transco which ensure that Transco and User interests are aligned. Obligations to provide reports to Users about specific trading activity is likely to reveal commercial strategies that would potentially act to the detriment of the efficient operation of the SP account. Transco is, however, obliged to report extensively to Ofgem about the SP procurement activity and Ofgem's oversight of the activity should provide assurance that Transco is not acting inappropriately in its role as SP.

Transco would nonetheless welcome views as part of this consultation as to whether Transco should be required to publish information about the SP trading activity that other market participants are not required to do. Additionally Transco seeks views should information be published as to what information and under what circumstances further information about its SP activities should be published paying particular regard to the timing of such information release.

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

The Proposal would remove an asymmetric feature of the arrangements that might be expected to generate underdelivery of gas into the account. Implementation of the Proposal will tend to reduce the costs of shrinkage and encourage physical gas flows onto the system in respect of the SP account which are more closely aligned with underlying system design assumptions and efficient operation of the system. Therefore implementation can be expected to improve the economic and efficient operation of the system.

Additionally the Proposal would enable Transco to manage exposures in the market place thereby potentially providing extra liquidity and trading and a means by which any excess SP gas can be sold in the NBP market. This could be expected to promote greater market efficiency and therefore further promote competition between Users.

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

The removal of the restriction on disposing NBP trades is likely to remove an asymmetry that might be expected to diminish the likelihood of the under-procurement of gas against anticipated daily SP quantities. Implementation might therefore give rise to an improved physical balance on the system.

b) development and capital cost and operating cost implications:

Transco does not envisage any development or capital cost implications. Operating cost implications are viewed as marginal. Any such costs will be shared with Users in accordance with the relevant SO incentive scheme.

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 such costs will be shared Users in accordance with the relevant SO Incentive scheme.

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

Transco does not believe that this Proposal would have any effect on price regulation

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

This Proposal affords Transco an opportunity to better manage the contractual risk to Transco under the SP terms.

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

No development issues envisaged.

7. The implications of implementing the Modification Proposal for Users

Users would be able to purchase NBP gas from Transco thereby potentially increasing the liquidity of the gas market.

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

No direct implications are envisaged.

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

Transco is not aware of any impact on legislative and regulatory obligations.

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

Advantages:

- May reduce shrinkage costs (a benefit to both Transco and the Community)
- May improve supply/demand balancing by encouraging Shrinkage Provider account to have procured gas close to end of day requirements early in the day
- Provides opportunity to increase NBP liquidity

Disadvantages:

- No disadvantages have been identified

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 invited.

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

This Modification 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

This modification is not proposed as a result of changes to the methodology established under Standard Condition 4(5).

14. Programme of works required as a consequence of implementing the Modification Proposal

Transco would be required to modify its internal procedures to facilitate disposing NBP trades.

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

Transco would want to implement this Proposal as soon as possible.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this Proposal is implemented.

17. Text

Section N

Amend paragraph 4.2.2 to read:-

“4.2.2 The Shrinkage Provider:

- (a);
- (b);
- (c);
- (d) may make Acquiring Trade Nominations and Disposing Trade Nominations in accordance with Section C6: provided always that the Shrinkage Provider may only make a Disposing Trade Nomination in respect of a Gas Day where the aggregate Trade Nomination Quantity of all Disposing Trade Nominations made by the Shrinkage Provider in respect of such Gas Day is less than or equal to the aggregate Trade Nomination Quantity of all Acquiring Trade Nominations made by the Shrinkage Provider in respect of the same Gas Day;
- (e);
- (f) may [not] post Market Offers;
- (g);
- (h)”

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:

Tim Davis
Head of Regulation NT&T

Date: