

Draft Modification Report
Changes to Buy Back Liabilities
Modification Reference Number 0559
Version 2.0

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

It is proposed to change the current capacity neutrality driver in the Network Code, MSEC, to end of day firm entry capacity holdings at the national level, including purchases of Monthly and Daily System Entry Capacity plus, for the avoidance of doubt, any other firm capacity products which may be introduced. The calculation of holdings would reflect firm capacity surrender and trades, being based on end of day holdings rather than the initial allocation. Costs and revenues generated on a day would therefore be shared based on Users' net firm capacity holdings on each day. Invoicing arrangements would be unchanged from those used at present.

It is proposed that this approach would be implemented with effect from 1st October 2002.

2. Transco's Opinion

Transco supports implementation of this proposal.

The capacity neutrality provisions in the Network Code require revenues and costs generated in the entry capacity regime to be allocated to Users according to their holdings of Monthly System Entry Capacity (MSEC). At present Users are unable to trade out their liability by selling on MSEC and no liabilities are attached to holdings of Daily System Entry Capacity. Transco believes that an efficient regime should enable Users to manage liabilities by trading on capacity and that a common liability regime should apply to all firm capacity.

This Proposal amends the present approach such that there is an opportunity for Users to manage liabilities by trading capacity. This would be expected to enhance liquidity in the capacity markets, which is consistent with promoting competition between shippers, and with providing appropriate signals to Transco about the value of capacity, which would be expected to assist in the economic and efficient operation of the transportation system.

Where Users enter zero priced buy-back offers prior to 17.00 hours on the gas day, Transco would, on a reasonable endeavours basis, accept these zero priced offers, thereby reducing the Users end of day firm entry capacity holdings. However to enable this change a Modification to the Operational Guidelines under Special Condition 17 of Transco's GT Licence may be required and in due course changes may be required to the supplementary statements in Ofgem's proposed modifications to the GT Licence were they to be implemented.

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

This proposal would increase the efficient and economic operation of the entry capacity regime by better enabling Users to manage buy back liabilities and could also promote competition between Users. It therefore furthers the relevant objectives in Standard Condition 7(1)(a) and (c) of Transco's GT Licence.

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

Increased liquidity in capacity markets and of buy back offers to Transco.

b) development and capital cost and operating cost implications:

No significant costs are anticipated.

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 additional System Operator costs incurred as a result of implementing this Proposal would be accounted for under the proposed internal cost incentive scheme, as set out in Ofgem's final proposals for System Operator incentives.

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

There are no such consequences.

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

There are no such consequences.

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

Systems developments will be required to implement this proposal and it is anticipated that these could be delivered at the end of October, to be included in the October capacity invoice.

7. The implications of implementing the Modification Proposal for Users

Implementation of this proposal would enable Users to trade out of their buy back liabilities either by surrendering capacity to Transco or trading it to another User. Increased liquidity could reduce buy back prices and hence capacity management costs which are shared between Transco and Users.

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

There are no such implications

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

There are no such consequences.

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

Advantages:

- Users will have an opportunity to trade out their buy-back liability;
- a daily calculation may enable better management of liabilities;
- discontinuities between firm capacity products will be removed;
- provide a stimulus to secondary market trading.

Disadvantages:

- requirement for more active capacity management at locations that might not be the subject of capacity management activity.

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.

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

Implementation is not required for this purpose.

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

Implementation is not required having regard to any such proposed change.

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

There are no additional works required.

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

Draft Modification Report issued	12th July 2002
Close-out for representation	26th July 2002
Final Modification Report issued	29th July 2002
Ofgem decision expected	1st August 2002
Implementation	1st October 2002
System delivered and first invoice issued	1st November 2002

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation.

17. Text

[Draft] proposed legal text

SECTION B: SYSTEM USE AND CAPACITY

Amend paragraph 2.13.1 to read as follows:

"....and certain other amounts in respect of each Day in a calendar month shall be payable...."

Amend paragraph 2.13.2 to read as follows:

"For each Aggregate System Entry Point, in relation to each Day:

(a)

(i)

(1)for the Day....

(2)

(ii) System Entry Overrun Charges; and

(iii) where any User has negative capacity....,

in respect of such Day; and

(b)

(i)attributable to the Day pro rata....

(ii)

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

Amend paragraph 2.13.3 to read as follows:

"In relation to each Aggregate System Entry Point and a Day, Transco shall pay to each relevant User an amount ("**Capacity Revenue Neutrality Charge**") determined as:

$$RCR * \frac{UFAC}{AFAC}$$

where:

RCR

UFAC is the aggregate sum of the User's Fully Adjusted Firm Available System Entry Capacity at each Aggregate System Entry Point; and

AFAC is the aggregate sum of all Users' Fully Adjusted Firm Available System Entry Capacity at each Aggregate System Entry Point,

[in each case as determined at [at 04:00] hours on the relevant Day]."

Amend paragraph 2.13.4 to read as follows:

"In relation to each Aggregate System Entry Point and a Day, each relevant User shall pay Transco and amount ("**Capacity Cost Neutrality Charge**") determined as:

$$RCC * \frac{UFAC}{AFAC}$$

where:

RCC

and 'UFAC' and 'AFAC' have the meanings in paragraph 2.13.3."

Amend paragraph 2.13.5 to read as follows:

"For the purposes of this paragraph 2.13:

(a) the "**Capacity Neutrality Adjustment Amount**" for a Day in a calendar month (month 'm') is the sum of:

(i)

(ii)paragraph (1) above,

divided by the number of Days in month 'm';

(b)

(c)

- (d) a "**relevant User**" is a User registered as holding Firm System Entry Capacity at an Aggregate System Point on the relevant Day."

Amend paragraph 2.13.6 to read as follows:

"In relation to a Day [(and all Aggregate System Entry Points)] where:

(a)

(b)

an amount ("**Capacity Neutrality Adjustment Charge**") determined as:

$$\text{CNAA} * \frac{\text{UFAC}}{\text{AFAC}}$$

where CNAA is the Capacity Neutrality Adjustment Amount and 'UAFC' and 'AFAC' have the meanings in paragraph 2.13.3 (provided that in the event no Firm System Entry Capacity was held by any User at any Aggregate System Entry Point on such Day 'UAFC' and 'AFAC' shall be determined on the basis of the most recent preceding Day in respect of which a User held Firm System Entry Capacity at an Aggregate System Entry Point."

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: