

Modification Report
Capacity Forward & Option Entry Capacity Management
Modification Reference Number 0498
Version 2.0

This 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

Transco anticipates that it will continue to have available the present daily capacity buy-back process described in section B2.9 of the Network Code, for the purposes of capacity management. In addition it believes that it would be appropriate to develop alternative mechanisms, including forward and options contracts, for entry capacity management. It is anticipated that the process for procurement and deploying of, any new tools would be defined in the Procurement Guidelines and System Management Principles Statement. However, in the interim Transco has raised Operational Guidelines change proposal OG25 to facilitate the development and deployment of such capacity management tools.

Initially two types of contract would be introduced, Forward and Option contracts. Forward contracts would consist of the surrender of an amount of capacity for a predefined period at an ASEP; Users would indicate the volume offered per day and the price (in p/kWh/day). Option Contracts would provide Transco with a right to exercise an option to buy-back up to an amount of capacity at an ASEP as specified in such contract. The detail of the contract specification would be at Transco's discretion. The option pricing structure would involve Transco publishing the exercise price (in p/kWh) and Users bidding a premium price (in p/kWh) and the volume offered. It is anticipated that Transco will define the precise details of the contracts on offer via an "invitation to tender", that would, along with a set of terms and conditions and an accepted bid form the contract between an individual User and Transco. Each Forward contract would be exercised immediately following acceptance. For Option contracts, Transco would be able to choose when to exercise up until a final date and time that would be stated in the invitation to tender. For further details concerning the operation and the possible use of capacity management tools, please see the attached business rules.

Transco believes that there would be benefit for the range of capacity management tools available to it to be enabled via the Procurement Guidelines and System Management Principles Statement respectively. However, in the interim the Operational Guidelines might be appropriate to define the procurement and deployment processes. If agreed, it would be appropriate for the present Entry Capacity management processes to be removed from the Network Code.

It is further proposed that the Network Code should be amended to enable changes in Users holdings of Entry Capacity as a result of it transacting with Transco for one or more of the System Entry Capacity based capacity management tools to be registered on the UK-Link System. Registration of such transactions is necessary to enable accurate calculation of overrun charges, Section I liabilities, and each Users share of

costs and revenues arising from capacity neutrality arrangements as described in Modification Proposal 520, should it be implemented.

A further change is also proposed to enable fees (payments to Users) for relinquishing capacity arising from an agreed entry capacity management transaction to be registered on capacity invoices. Credits would appear on invoices produced at the end of the month to which the contract applied, and where contracts span months would include a pro-rata proportion of the forward contract and option premium charges based on the relevant number of days. Option exercise charges would be including in the invoice for the month to which the exercise related.

It is intended that, if agreed, the revised processes should be in place for 1 April 2002.

2. Transco's Opinion

Transco supports implementation of this Modification Proposal. It believes that an increased range of capacity management tools may offer Transco a greater opportunity for effective and efficient capacity management. This would afford benefits to both Transco and Users. At present its management of firm entry capacity is limited to the use of capacity buy-back on a "spot" or "prompt" basis. Forward looking tools, such as those that would be enabled through this Modification Proposal, will complement the use of "prompt" or "spot" arrangements. Such a facility may afford further opportunity for Transco and Users to agree more efficient capacity management arrangements.

Transco believes that the benefits that might arise from the use of forward contracts might be:

- lower level of costs
- more predictable capacity management costs
- better management of the financial risk profile
- the more efficient scheduling of maintenance

A potential for lower costs could arise because forward contracting should offer Users a greater opportunity to re-schedule their activities if agreements are entered into and are utilised in advance of the gas day. Lower costs may then be realised by reducing risks to Users by providing a greater opportunity for Users to adjust their portfolios ahead of the gas day to better facilitate capacity management.

Use of Forward and Option contracts to manage capacity could reduce the expectation and/or variability of capacity management costs. These benefits could arise both from simply providing an indication of costs in advance of calling upon capacity management tools and through a potential reduction in the frequency and extent of price spikes that might otherwise be expected to arise from continued reliance on the short term buy-back process. That stability could help both Users and Transco to gain a greater understanding of expected outcomes against Transco's proposed buy-back incentive, including providing Users with an indication of their exposure to capacity neutrality costs.

The process of forward contracting could provide Transco with a market based signal that will help inform the timing of scheduled NTS maintenance activity.

Transco envisages that, in line with Ofgem Final Proposals for the System Operator Incentive Schemes and the associated licence revisions, Procurement Guidelines and System Management Principles Statement documents will be developed which will define the approach that Transco will use to procure and deploy such tools respectively. This Proposal originally envisaged that both documents would be developed and implemented prior to 1st April 2002. Due to the delay in publication of Transco's revised GT Licence, Transco has raised OG25 to perform the function of the System Management Principles Statement and Procurement Guidelines in respect of Capacity Management Agreements. It is anticipated that the System Management Principles Statement will contain guidelines for the deployment of capacity management tools including the existing buy-back mechanism. The Procurement Guidelines will outline the tools that Transco expects to purchase and the mechanisms used. Both aspects would be included in the Operational Guidelines until Transco's revised GT Licence is implemented. However some aspects of the existing buy-back mechanism such as the process for posting offers, will remain within the Network Code.

This Proposal would enable Transco to manage the entry capacity regime using a wider range of contractual tools designed to facilitate more efficient regime operation. Decisions between contracting forward or waiting to see if buying back capacity in the prompt market is necessary would be subject to Transco's risk management assessment.

A choice of tools and of when to contract for those tools could enable Transco to achieve more efficient and economic entry capacity management. This will provide both Users and Transco with benefits if a more efficient outcome is gained in the context of the System Operator buy-back Incentive.

Transco may consider the resale of any capacity bought back having due regard to its obligations.

In Transco's opinion it is appropriate that prices derived from Capacity Management Agreements should be treated in the same way as buy-back bid prices for the purposes of overrun charge and Section I payments determination. For overrun charge determination, this would include consideration of the exercise price part of an options contract where that contract was exercised on the day and the price for forward contracts where the day on which the overrun occurred was the subject of either form of agreement. For Section I charges, the exercise element of an option contract would be included where the option was available for exercise but not taken. This will provide the appropriate incentives on Users to purchase capacity and on Transco to either buy-back or forward contract for capacity in the market place. It should be noted that until new systems are implemented in August 2002, option and forward contracts will be treated exactly the same as buy-back offers for the purposes of these calculations.

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

The Proposal might afford Transco an opportunity to operate its pipeline system more efficiently and economically, as it enables a greater range of tools to be considered in the capacity management processes. It may also allow Transco to operate more effectively under its proposed capacity buy-back incentive, the parameters of which have been set assuming such tools are available. It is arguable that the risks for Users who choose to offer capacity surrender will increase as the timing of any transfer of rights moves closer to the period in which the capacity is required. Increasing risks may generally be expected to be reflected in the prices offered by Users in return for surrendering capacity. Therefore it is hoped that forward and option contracts could both reduce risks for Users and reduce capacity management costs for Transco. The structure of such contracts may also allow more Users to participate in the capacity management process, for example forward contracting may enable some Users who do not have very short term gas flexibility and who are unable to compete in the within day market, to participate. Thus the proposed arrangements should be expected to 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 Proposal may enable Transco to manage entry capacity in a more efficient and economic manner. It will have no direct effect on the day to day operation of the System, however it may allow Transco to schedule maintenance and development of its System at those times when capacity is less valued by Users.

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:

This proposal is consistent with assumptions made in setting the System Operator Incentives.

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 may reduce contractual risk for Transco, as it may reduce the forward exposure via the buy-back incentive that Transco would otherwise face, however this should be set against Transco's ability to accurately predict the appropriate level of forward contracting.

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, it is anticipated that these will be delivered at the beginning of August 2002. If Transco chooses to purchase capacity management tools before this then off-line mechanisms will be used to operate such contracts.

7. The implications of implementing the Modification Proposal for Users

This Proposal may lead to a more efficient and economic entry capacity regime. The sharing factors in Transco's proposed capacity buy-back incentive mean that Users are aligned with Transco in seeking to reduce the costs of capacity management. The Proposal will provide options for Transco in respect of capacity management, providing additional commercial opportunities for Users, increasing competition in the provision of services between Users and may lead to lower overall levels of capacity management costs. The Modification Proposal also provides Users with the opportunity to contract with Transco in advance of the gas day, although they would not be obliged to do so. This may provide additional commercial and operational benefits.

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

None 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

In addition to the changes to the Network Code, a number of changes may be required to Transco's GT Licence to enable the implementation of entry capacity management contracts. There is a possibility that this Modification Proposal could impact on the Transco exemption under the FSMA. Transco anticipates that Ofgem and Transco will be exploring these issues with HM Treasury. Licence Condition 7 applies to contracts related to the Network Code, requiring their individual derogation by Ofgem. New Licence wording might provide degree of certainty to avoid this complexity and could be included within either existing conditions or a new condition describing the Procurement Guidelines but they would be subject to the outcome of the HM Treasury discussions. It is anticipated that these issues will be dealt with in a

consistent manner through the changes required to implement Transco's new price control formula.

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

Advantages:

- The Proposal would be expected to enable capacity management to be carried out in a more efficient and economic manner.
- The Modification Proposal is intended to enable alternative tools for capacity management, it does not imply any obligation on Users or Transco to use such tools
- The use of forward contracting for capacity management may further promote the development of a forward price curve for capacity and a more liquid secondary market

Disadvantages:

- Users may need to develop predictive models to assist them in valuing capacity management contracts
- The development of option and forward contracts for capacity management will add complexity to the Entry Capacity regime

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

Representations have been received from nine respondents.

Powergen (Powergen)

BP Gas (BP)

Scottish & Southern Energy (SSE)

Shell Gas Direct (SGD)

Agip (UK) Ltd (Agip)

Innogy (Innogy)

British Gas Trading Ltd (BGT)

TXU Europe Energy Trading Ltd (TXU)

TotalFinaElf Gas and Power Ltd (TFE)

Dynegy UK Ltd (Dynegy)

One respondent (Dynegy) supports this proposal.

Five respondents (TFE, TXU, Innogy, BGT, Agip) do not express a definitive position in respect of this Modification Proposal.

Four respondents (Powergen, BP, SSE, SGD) do not support the Proposal.

General View

Seven respondents (TFE, TXU, Innogy, Agip, SSE, SGD and BGT) advise that in principle they recognise the need to increase the tools available to Transco for capacity management. However all the respondents express the view that, due to the delay in the publication of the proposed GT Licence amendments, Procurement Guidelines and System Management Principles Statement, they are unable to give this Proposal full and appropriate consideration. All respondents expressed the general

view that given the delay to the publication of Ofgem's Licence proposals, which might influence changes in Transco's behaviour in response to its SO incentives and discharge of its licence obligations, they do not consider that they are in a position to properly evaluate the likely impacts of this Proposal. Furthermore respondents share the view that their evaluation of the Modification Proposal is hindered by the delay in publication of Transco's proposed procurement and deployment details for both the forward and option contract arrangements. The Modification Proposal suggested that forward and option contract arrangements be incorporated within Transco Procurement Guidelines (PG) and System Management Principle Statement (SMPS) documents. Most respondents argued that as neither of these documents have been published or discussed with shipping community it is difficult to provide an opinion on this Proposal. BGT expresses the view that it offers, "...conditional support for the principles set out in the Modification Proposal, with the caveat that the System Management Principles and the Procurement Guidelines or alternatives, together with the licence amendments are published before the forward and option contracts envisaged under this Proposal are implemented". TFE expresses concern that, "Delay to the publication of Transco's Procurement and Deployment Guidelines, System Management Principle Statement and the absence of the Ofgem Licence proposals generates uncertainty and potentially significant commercial risk to the shipping community". TFE advises that although it supports the principles of developing additional capacity management tools, in the absence of such documents it is "...unable to confirm any definitive decision either in favour or against the detail of this particular Proposal". BGT expresses the view that due to the delay in the publication of Ofgem's licence amendments it is unable to submit any reasoned analysis of the implications of this Modification. SSE observes that in the absence of the licence proposal, Procurement Guidelines and System Management Principles Statement, "...there is no clarity in relation to the proposed tender, duration, criteria and operation of the contracts". TXU adds that "Shippers are left without a clear view of what Transco's incentives will be regarding capacity management...". TXU suggest that, "The level of uncertainty makes it very difficult to provide support for this Modification...".

Innogy notes that Transco's aspiration to have the PG and SMPS changes in place before April 2002 looks increasingly unlikely. It raises concerns that there are no alternative proposals or contingency arrangements brought forward. Innogy is concerned that, "...delaying the introduction of these system management tools may expose Transco and therefore MSEC holders to increased capacity buy-back costs during the upcoming summer period".

Transco Response:

Transco sympathises with Users' views concerning the delay in publication of proposed amendments to Transco's GT Licence. The uncertainty about new licence requirements in this area has delayed discussion about the detail of the Procurement Guidelines and System Management Principles with Users. Transco believes that Ofgem has given a clear indication in published documents that it believes enhanced capacity management tools should be available to Transco and, furthermore, that their governance should be defined by the Procurement Guidelines and System Management Principle Statement documents. Transco has, however, outlined the anticipated form of the documents at a high level during Workstream meetings.

Transco does not believe that discussions surrounding the nature of Procurement Guidelines should have an effect upon this Proposal, which is limited in nature and seeks to enable the use of additional tools and for these to be reflected in Network Code arrangements such as invoicing and capacity registration.

Transco welcomes support from a number of Users for the principle of additional capacity management tools. Transco believes that it should have early access to additional tools in order to manage entry capacity, and believes that this Modification Proposal is an appropriate step towards that. Given the delay to introduction of the Procurement Guidelines and System Management Principles statements, Transco has raised OG25 to amend the Operational Guidelines. This would enable the Operational Guidelines to fulfil the role envisaged by the Procurement Guidelines and System Management Principles in respect of Capacity Management Agreements. OG25 is presently the subject of the appropriate consultation process.

Governance and Regulatory Control of Proposed Contracts

SGD expressed concern over the proposed changes to regulatory control and observes that it, "... appears that regulatory control of the market is increasing with control of the contract between shipper and Transco migrating to private negotiations between Ofgem and Transco".

Powergen does not believe that it is appropriate to introduce new Procurement Guidelines and System Management Principles Statement and suggests that it is inevitable that regulation will become more difficult. Powergen expresses concern that governance will be weakened as Transco propose to take more trading arrangement rules out of the Network Code and suggest that this would be, "...of fundamental commercial concern to Shippers". Powergen states that, "It does not want to see the fragmentation of documents, policies, procedures, methodologies and Codes as experienced in electricity".

Dyengy propose that "an ex-poste auditing process would allow a means of monitoring the level of efficiency gained from the additional tools".

TXU does not accept the view expressed by Transco that the current daily buy-back management should be incorporated into the Procurement Guidelines and System Management Principles Statement. It argues that "daily and within day management of the entry capacity is an important part of Transco's interaction with Users and as such it is vital that both Shippers and Transco have the ability to propose changes and develop the process as necessary".

Transco Response:

Transco understands concerns expressed by respondents about increasing complexity and believes it has a shared concern with Users to maintain clear governance arrangements. Issues regarding the appropriateness of introducing Procurement Guidelines and Systems Management Principles and their relationship to wider GT licence requirements are policy decisions that all parties can address through the licence consultation process.

Transco recognises shipper concerns regarding the auditability of Transco's use of new capacity management "tools", but expects the requirements will be dealt with through normal business processes.

It is for reasons of clarity and consistency of governance that Transco believes that all capacity management tools, including daily capacity management, should be governed by similar arrangements so that efficient and consistent decisions are taken.

Transco's Role

Six respondents (TFE, Innogy, BGT, AGIP, SSE and TXU) support the principle that Transco should be encouraged and empowered to develop new capacity management tools. TXU observes that, "This would enable them to conduct Capacity Management with a greater degree of choice in the tools they use. This should encourage efficiency in capacity management and therefore benefit Shippers and End Users". Innogy states that it supports, "... the introduction of this commercial freedom for Transco and believes that it will lead to more efficient actions and see the development of a range of competitive services". BGT considers that permitting Transco to enter into forward and option contracts would enable Transco to manage its exposure to the commercial incentives it may be subject to. SSE advises that, "In the longer term, we agree that ultimately all constraint management tools, including the buy-back provisions within the Network Code should be subject to the same governance as the forward/option contracts."

SGD supports the concept of introducing new capacity management tools suggesting that this could provide some stability to the prices associated with capacity management. SGD advises that, "It would expect that this will reduce high spikes in buy-back costs which should reduce shippers exposures to capacity buy-back smearing".

Two respondents (Powergen and Innogy) note that extending the boundaries of Transco's role requires further consideration. Innogy raises concerns that, "... the boundaries within which Transco will operate in this extended role have yet to be fully defined and understood". Innogy reminds that Transco would be operating as a monopoly provider of capacity as well as a trader of capacity, noting that this would be within the constraints of its licence obligations.

Powergen is concerned that, "This proposal may lead back to a more centrally (Transco) planned world, which runs counter to Ofgem's usual 'Market Based' view of the world". Powergen recalls that one of the principles of both the introduction of the Network Code and reforms to gas trading arrangements in 1999 was that Transco's trading role should be as minimal as possible. Powergen believes that this Modification Proposal will lead to a lack of transparency and that ["insider information means Transco will inevitably distort market prices, if only to maximise their gains under the SO incentives"](#).

Transco Response:

Transco welcomes the high level of support from Users for the principles underpinning development of new capacity management tools. It agrees with SGD

that forward contractual tools could provide greater price certainty than is available through sole reliance on the prompt buy-back tool.

Transco recognises the concerns expressed by a number of respondents about the potential freedom extended for Transco to fulfil a wider trading role. However, it believes that respondents' fears are not well founded and that freedom granted to Transco in this respect will be governed by the implemented framework defined initially by the proposed OG25 changes and subsequently by the development of the Procurement Guidelines and System Management Principles. Transco believes that forward contracting may stimulate capacity trading activity by enabling more Users to offer capacity for surrender, as it will enable those Users without short term flexibility to partake.

Option Contracts

Powergen observes that the Options Contract proposed in this Modification would provide Transco with an information advantage and that it would "... become effectively a 'Market Maker' where they are owner, operator, buyer and seller on the system. "Powergen expresses concern that by Transco having a more complete view of the market Transco actions may distort market prices and states that it is "...sceptical that this will result in a more economically efficient outcome".

In respect of the option contracts TXU considers that, "... they should remain consistent with standard option products on other commodities as possible". It recommends that, " ... as such the payment for premiums should be made when the option is struck, rather than during the period the option can be exercised...".

Transco Response:

Transco expects to operate capacity management within an incentive framework that will encourage it to manage both expected costs and the risk/reward inherent in the regime. With regard to costs, the market process dictates that Users set the price and it remains for Transco to optimise capacity management action requirements. Transco therefore supports the ability to use forward contracting because it offers an additional tool to facilitate capacity management.

Transco welcomes Users' comments on the design of the contracts to be developed, although they are not directly related to this Modification Proposal. It believes that the nature of contracts will evolve to match the needs of both Transco and Users over a period of time. In this respect Transco has considered it appropriate to develop simple products at the outset, but expects to build upon experience gained and feedback from its customers.

Transco has, since close out of the consultation period applicable to this Proposal, discussed the form of such contracts with Users and is currently considering the most appropriate form of contracts. It would welcome further views from Users on the issue.

Long Term Capacity Arrangements

BP expresses the view that it would be more appropriate to discuss entry capacity management tools after the new capacity arrangements are in place, under consideration via Modification Proposals, 0500 and 0508. It suggests that the dynamics of capacity management tools may have a linkage to decisions whether to build incremental entry capacity. BP states that until the new entry capacity arrangements are known, "... it is not possible to make a full judgment of the appropriateness of the proposals within the Modification".

SSE suggests that it would be more appropriate to, "...concentrate on a more enduring regime from 1 October 2002, by which time the longer-term capacity regime should be finalised".

Transco Response:

Transco agrees that there will be a process of further development of capacity management tools. However Transco remains concerned to manage risk over the summer of 2002. This requires early use of what might be considered comparatively simple products, with further development possible in the medium term.

FSMA Implications

Powergen notes that it is unclear what changes will be necessary to Transco's GT licence including any FSMA implications. SGD and SSE believe that further consideration of the FSMA issue arising from the operation of these contracts is required. SSE notes that, "Further discussions with Shippers will be required so that we have a full understanding of the implications of the Financial Services Act now that Transco will be trading for non-physical product more than 7 days in advance".

Transco Response:

Transco believes that the Licence issues, which relate to derogation from Ofgem for any contract outside of the Network Code, can be managed in the short term and that the FSMA implications can be resolved via the terms and conditions for the contracts.

Better Facilitation of Relevant Objectives

SGD suggests that, "...without being able to consider issues raised following an informed process, it is unclear how Ofgem can judge whether this Modification better facilitates the relevant objectives". SGD recommends that Ofgem rejects this Modification, as it cannot be shown that it furthers the relevant objectives. It proposes that further consultation on the development of capacity management tools should take place with a proposed implementation date of 1 October 2002.

Transco Response:

Transco believes that this proposal better facilitates the relevant objectives, because it will enable Transco to operate the entry capacity regime more efficiently and economically. For example, SGD has noted that forward contracting will enable a reduction in high spikes in buy-back costs which should reduce User's exposure to capacity buy-back smearing. Transco also believes that use of the proposed tools may

enable it to reduce the general level of capacity management costs by both increasing the number of Users willing to offer Transco capacity and by reducing the risks associated with such offers.

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

Implementation is not required to enable Transco to comply with any 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

Implementation is not required having regard to any proposed change in the methodology established under Standard Condition 4(5) of the statement furnished by Transco under Standard Condition 4(1) of the Licence.

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

There are no such works required.

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

Transco proposes implementation with effect from 1 April 2002.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

TRANSITION DOCUMENT,

PART II

Insert new paragraph 8.1.2A to read as follows:

- "8.1.2A B2 For the purposes of the calendar months April 2002 to September 2002 (inclusive):
- (1) Transco may, for the purposes of Capacity Management:
 - (a) initiate a capacity selection period in accordance with the Operational Guidelines;
 - (b) accept daily capacity offers on any Day in accordance with the [Operational Guidelines] at an Aggregate System Entry Point in such aggregate amounts as is consistent with the [Operational Guidelines] (and acceptance of daily capacity offers during each capacity selection period shall for the avoidance of doubt not be limited to quantities of Firm System Entry Capacity equal to any prevailing Firm Capacity Shortfall); and
 - (c) Sections B2.9.8 to B2.9.13 (inclusive) shall not apply.
 - (2) the:
 - (a) "**Capacity Management**" means, in relation to an Aggregate System Entry Point and in relation to any Day:
 - (i) the entering into of agreements for the purposes of the management of a capacity constraint by Transco and a User; and/or
 - (ii) the curtailment of Interruptible System Entry Capacity in accordance with the [Operational Guidelines] and Section B2.10; and/or
 - (iii) the acceptance by Transco of daily capacity offers submitted by Users in accordance with the [Operational Guidelines] and Section B2.9,in each case for the purposes of the management of a capacity constraint;
 - (b) "**Capacity Management Charges**" are all amounts payable by Transco to a User pursuant to a Capacity Management Agreement; and
 - (c) "**Operational Guidelines**" are the Operational Guidelines established by Transco pursuant to Special Condition 17 of the Transco Licence.

- (3) For the purposes of Capacity Management Transco may enter into a Capacity Management Agreement with a User.
- (4) Where pursuant to the terms of a Capacity Management Agreement a User surrenders Firm System Entry Capacity at an Aggregate System Entry Point in relation to a Day, the amount of the User's Available Firm System Entry Capacity held by the User at the Aggregate System Entry Point shall be reduced by the amount surrendered by the User pursuant to the terms of the Capacity Management Agreement.
- (5) For the purposes of:
 - (i) Section B2.12.3(a), in determining the highest accepted offer price in respect of a Day, account shall also be taken of the price (in pence/kWh/Day) paid by Transco pursuant to a Capacity Management Agreement in respect of the surrender of System Entry Capacity on such Day (provided however that no account will be taken of any amount paid by Transco pursuant to Capacity Management Agreement by way of a premium and which for any other purpose under the Code is determined as attributable to such Day);
 - (ii) Section B2.13.3, Relevant Capacity Costs in respect of an Aggregate System Entry Point in relation to a calendar shall include the aggregate amount of Capacity Management Charges payable by Transco and attributable to a Day in such month (for which purposes any premium payable by Transco shall be attributable to a Day pro rata to the number of Days during which Transco may exercise rights in respect of the surrender of Firm System Entry Capacity pursuant to the relevant Capacity Management Agreement); and
 - (iii) Section I3.7.2, for the purposes of determining the aggregate notional surrender costs on a Day in respect of an Aggregate System Entry Point, account shall also be taken of the price (in pence/kWh/Day) payable by Transco pursuant to a Capacity Management Agreement were Transco to exercise its rights thereunder) in respect of the surrender of System Entry Capacity on such Day (provided however that no account will be taken of any amount payable by Transco pursuant to the Capacity Management Agreement by way of a premium and which for any other purpose under the Code is determined as attributable to such Day)."

Signed for and on behalf of Transco.

Signature:

Tim Davis
Head of Regulation NT&T

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0498**, version **2.0** dated **19/03/2002**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **2.0**.

Signature:

Process Manager - Network Code
Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.