Draft Modification Report
Reduction of Overrun Charges for System Entry Capacity
Modification Reference Number 0401

Version 6.0

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

This proposal seeks to ensure that all entry capacity is made available at all terminals at "reasonable cost" to help Transco fulfil its relevant objectives. It proposes that different overrun charges apply at ASEPs on "Constrained Capacity Days" and capacity unconstrained days, where a constrained day is identified as one on which Transco curtailed or bought back firm capacity rights at the ASEP.

On gas days when an ASEP is unconstrained a User who delivers gas in excess of the User's Available System Entry Capacity at the ASEP shall pay an overrun charge calculated as:

a) 1.1* C where C is the highest bid price pursuant to any daily capacity which was accepted by Transco in respect of the Aggregate System Entry Point for the day.

Or

b) 2* the reserve price applicable to the ASEP, in the Monthly System Entry Capacity auctions, if no daily capacity has been sold.

On "Constrained Capacity Days", where Transco has bought back, scaled back or curtailed firm capacity at the ASEP for all or part of the gas day, the overrun charges shall be the greater of;

a) 6*B, where B is the applicable Daily Rate for the Monthly System Entry Capacity at the ASEP on the gas day.

Or

b) the lesser of: i)1.5*D, where D is the System Average Price for that day; or

ii) 0.4p/kWh

2. Transco's Opinion

Transco sees merit in the principles and the broad intent of the modification proposal, although it has a number of concerns regarding the precise details of the overrun mechanism suggested in the proposal and, on balance, it does not support this modification proposal.

Transco has recently raised an urgent modification proposal (No. 0408) that also contemplates an amendment to the level of entry overrun charges, but differs in the details of the overrun charging calculations.

The objectives and appropriateness of the present overrun charge mechanism that was introduced in October 1999 within RGTA has been discussed within recent RGTA meetings, and the consensus reached has been that it may be appropriate to amend the present mechanism to take account of whether or not a terminal is "constrained" , and to reduce the level of overrun charges if the terminal is "non-constrained". In this respect the modification proposal meets the broad objectives expressed by the RGTA workgroup.

However, in Transco's view, the precise level of overrrun charges suggested in this modification proposal, in particular for "non-constrained days", would represent a precipitate change and would not maintain an incentive on shippers to book sufficient levels of entry capacity in the first instance. Specifically, the proposal to replace the "8 * applicable daily rate" with a "2 x MSEC reserve price" factor to set overrun charges could in some circumstances lead to a situation where the level of prices paid for the purchase of capacity at the primary auctions would be higher than the level of overrun charges. This could reduce the effectiveness of overrurn charges, undermine the "ticket to ride" principle, and effectively introduce a cap on bid valuations in auctions of firm entry capacity.

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

In the proposer's view, the proposed modification would facilitate competition in the UK gas market through improving liquidity in the secondary trading market, and would improve the economic operation of the NTS through the release of further capacity to shippers. In Transco's view, however, the proposed level of overrun charges could reduce the incentive on shippers to book capacity in advance of flowing gas and may reduce the efficiency of the primary auctions, both of which could compromise the economic operation of the NTS.

4. The implications for Transco of implementing the Modification Proposal , including

a) implications for the operation of the System:

The proposed reduction in overrun charges would reduce the incentive on shippers to keep to their capacity limits which would increase the likelihood of overruns. This may lead to an increase in the number of constraints and hence an increase in the frequency of issuing TFA's (Terminal Flow Advice).

b) development and capital cost and operating cost implications:

Any additional development costs arising from the need to distinguish between "constrained" and "non-constrained" days are anticipated to be minimal.

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:

There would be no change to transportation charges resulting from implementation of the modification proposal, and any additional costs will be absorbed within the price control.

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

No significant consequences would be expected.

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

The reduction in overrun charges for both "constrained" and "non-constrained" days may reduce the levels of booked capacity which would decrease the level of contractual risk to Transco in respect of its obligations to make capacity available to shippers.

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

The RGTA capacity system and Billing system would need minor changes to distinguish between "constrained" and "non-constrained" days and hence apply the appropriate overrun charges. Transco is not aware of any changes to Users' computer systems that may be necessary.

7. The implications of implementing the Modification Proposal for Users

Users would typically face a significant reduction in entry overrun charges, which may aletr their view of the relative value of firm and interruptible capacity rights.

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

Transco envisages a reduced correlation between booked capacity and gas flows. This could increase uncertainties for terminal operators when forecasting anticipated gas flows.

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 :

a) the proposed level of overrun charges would take into account impacts on the system arising from shippers exceeding their capacity entitlements

b) encourages shippers to make gas available to the system

c) improves liquidity in the trading of secondary capacity (as shippers might be more willing to release surplus capacity)

d) reduces likelihood of capacity hoarding by shippers

Disadvantages :

a) A multiplier of 2 x reserve price may be seen as providing a cap on auction valuations, thus reducing the efficiency of the allocation.

b) On "non-constrained" days in particular, reduces incentive on shippers to book entry capacity in the first instance

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