URGENT Modification Report
Change to System Prices
Modification Reference Number 0420
Version 2.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because it has concerns about Shipper' behaviour in the balancing market and the potential impact of certain aspects of the energy balancing regime on this behaviour, including Shipper tolerances, cash-out and Transco's energy incentive mechanism. In particular, Ofgem indicated in its recent document "The New Gas Trading Arrangements : A review and decision document", that the current cash-out and tolerance regime may be encouraging Shippers to take end of day imbalance positions.

Ofgem also notes concerns that under the existing end of day cash-out, tolerance and the energy incentive arrangements Shippers may have incentives to take within day positions that influence BG Transco's balancing behaviour thereby potentially securing a favourable end of day cash-out price for those Shippers.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Issued to Ofgem for decision on urgency	15 August 2000
Proposal agreed as urgent	16 August 2000
Proposal issued for consultation	17 August 2000
Close out for Representations	31 August 2000
Final report due to Ofgem	7 September 2000
Ofgem decision expected	14 September 2000

1. The Modification Proposal

"This proposal seeks to ensure that on all gas days there is a difference between SMPs and the SAP in order to encourage shipper balancing and to better reflect the costs associated with imbalances". The proposer believes that "ending the artificial SMPs (both buys and sells) should allow Transco to better fulfil their relevant objectives by improving the efficiency of the system and insuring system prices are a reasonable representation of the economic situation on the system".

The proposer argues that the Network Code should charge shippers SAP for all energy imbalances within the shipper’s tolerance. However, where the shipper is outside his tolerance it should be charged a different amount, as the average cost of the imbalance is unlikely to be equal to SAP and the Shipper's balancing would impact on the efficiency of the network, of which it is only one user.

It is proposed that the “System Marginal Buy Price” should, therefore, be equal to the higher of the highest “Market Offer Price” in relation to a “market balancing action” taken for that day, or the average of the seven previous days SMP buys.

The “System Marginal Sell Price” would be the lower of the Market Offer Price in relation to a “market balancing action” taken for that day, or the average of the seven previous days SMP sell.

On days when Transco takes no market balancing actions then the SAP is also the average of the previous seven days SAP (as is the case under Section F 1.2.2), but the rules on SMPs, as outlined above, would also stand.

2. Transco’s Opinion

The Network Code principles in respect of System balancing were originally agreed that;

-shippers should face commercial incentives to achieve an energy balance,

-Transco will act on behalf of shippers in the role of a residual balancer.

Transco believes that this is still the preferred basis for operation of the regime.

Cashout is the mechanism used to deliver these incentives and must provide appropriate signals for shippers to balance. The tolerance regime, introduced to provide protection against cashout risks, should protect against genuine operational uncertainties. However, Transco believes that there may be a mismatch between the aggregate amount of balancing tolerance available to shippers and the ability of the System to accommodate an imbalance. Transco notes in the report for Modification Proposal 0421 that if more developed linepack/tolerance services are not introduced shortly after 1 April 2001 then the distribution of tolerances may need to be reconsidered.

Transco has expressed concern that since the implementation of the NGTA it has observed a greater tendency for shippers to adopt imbalance positions and that at times the aggregate effect of these imbalance positions has made System balancing very difficult. Difficulties arise as the market conditions that are likely to provide incentives for shippers to adopt a particular imbalance position but such effects are not always clear to Transco.

Transco believes that setting more frequent SMP/SAPs differentials may have significant benefits through encouraging shipper to shipper trading and providing shipper incentives to balance. Such differentials may also provide a better approximation to cost targeting.

The mechanism for setting of the SMP/SAP differential needs careful consideration. Excessively penal differentials might inflate Shipper costs of balancing; whilst neutrality costs might be expected to come down, shippers might incur far greater costs in respect of their own balancing activities. Differentials set at too modest a level might fail to send the appropriate signals.

Transco believes that the proposal advocates a method of differential price setting that would improve the economic and efficient operation of the regime and therefore advocates its implementation. However, Transco believes that there may be better methods of setting SMP/SAP differentials and that the interaction between gas cash-out price setting and Transco’s energy incentive require further thought.

During the consultation period of this proposal the community have considered different approaches to cash-out price setting based upon formulations involving System Weighted Average Marginal Prices and fixed differentials derived from historic regime operation. Transco believes that these are worthy of consideration. Responses to this consultation indicate that in formulating further proposals to set cash-out differentials the trade-off between the risk of commercial manipulation and the degree of cost reflectivity need to be carefully considered. If necessary, Transco will consider whether it is appropriate to raise a further Modification proposal in this area to consider further cashout regime enhancements.

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

The proposer argues that "this proposal seeks to ensure that on all gas days there is a difference between SMPs and the SAP in order to encourage shipper balancing and to better reflect the costs associated with imbalances.   Ending the artificial SMPs (both buys and sells) should allow Transco to better fulfil their relevant objectives by improving the efficiency of the system and insuring system prices are a reasonable representation of the economic situation on the system".

The proposer further argues that "an alternative cashout regime should also help better facilitate effective competition. At the moment it is only larger shippers with relatively flexible gas production facilities that appear likely to benefit from forcing balancing action and then ensuring cashout of their imbalance at a favourable price. These shippers have an unfair advantage at the expense of smaller players, or those with gas flows from offshore that they cannot control. Players competing on a level playing field should be good for customers as it will result in effective competition and thus lower prices".

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

a) implications for the operation of the System:

Enhanced balancing incentives may lead to improvements in shipper balancing and thereby reduce the extent of end-of-day imbalance experienced by the System. Enhanced end-of-day incentives may also lead to a change of behaviour in respect of within-day balancing and thereby reduce the extent of within day supply/demand imbalances. Both these effects would contibute to improving System security and more cost effective System balancing.

b) development and capital cost and operating cost implications:

Implementation of the proposal would require some minor changes to the AT Link system and other computer systems, but costs would 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:

Any additional costs will be accounted for under the price control formula.

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

No such consequences are anticipated as imbalance revenues are managed within the Balancing Neutrality Mechanism.

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

Implementation of the proposal would affect the Transco Energy Incentive because of the linkage with System Marginal Prices. The form of the incentive is the subject of Modification Proposal 0414 - Energy Incentive Redesign.

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

Transco believes that if this proposal is implemented then system changes would be required. Such changes would affect AT Link and also off-line support tools used to calculate the SMPs.

EnMO has indicated that if this proposal is implemented so that the SMPs are calculated through a revised method then OCM systems would have to be modified in order that EnMO may continue to provide an on-screen indication of the relevant prices.

7. The implications of implementing the Modification Proposal for Users

Shippers would have enhanced incentives to achieve an imbalance position within their Imbalance Tolerance Quantity to avoid having gas deliveries cashed out at System Marginal Prices. This should encourage improved balancing and reduce the potential for balancing mechanism costs to be misallocated between users. Shippers may be required to secure greater supply flexibility to manage demand changes. Alternatively, Shippers may manage the risk through trading gas imbalances either through the OCM or through other markets. This could enhance liquidity in these markets thereby increasing the scope for better balancing.

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

No such implications are anticipated.

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 consequence have been identified.

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

Advantages;

Improved incentives for shippers to balance
Potentially reduced requirements for Transco balancing actions
Reduced mis-allocation of costs between shippers through cashout at SAP
Encouragement of trading of imbalances between shippers

Disadvantages;

SMP prices may not be market reflective
Cashout prices may be unduly affected by price 'spikes'
May disproportionately affect those shippers with inflexible contracts

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

There were 18 representations submitted in response to this proposal. Of these there were 7 that clearly did not support the proposal. A number of others supported the intent of the proposal but made comment that the objectives stated for the proposal would be better met using an alternative approach.

The HSE responded noting "concerns expressed by Ofgem and the gas industry regarding shippers' behaviour in the balancing market and the potential risk that this may pose to system security. HSE has been in discussions with Transco regarding the extent to which such behaviour may be the result of parties failing to comply with regulation 6 of the Gas Safety (Management) Regulations 1996.

HSE would support, and expects, changes to the Network Code which reduce the risk to system security."

The proposer, V-is-on, made a representation to clarify an issue that had been identified in workstream discussions. " The point of the modification was to ensure a buy sell spread of system prices on all days to stop shippers being incentivised to take long or short positions when one side of the market was equal to SAP. The drafting therefore needs to ensure a system buy is never lower than SAP or system sell higher than SAP in any day."

Transco notes this clarification and in line with the declared intent of the proposer, has progressed the proposal to address this anomaly which might have created the risk of perverse incentives on shippers to adopt imbalance positions.

The other issues raised in representations have been grouped as follows; SMP differentials; Alternative approaches to determine SMP; Interaction with other Modifications.

SMP differentials

BGT supports the introduction of a revised cashout regime that provides for the setting of marginal prices in the event that they have not been set by Transco action. This should enhance shipper incentives to balance to within tolerance levels and remove the commercial incentives for within day profiling by shippers. However it maintains that "changes to the cashout regime alone should not be relied upon as providing the main incentive for shippers to balance. Any model for deriving cashout prices can only be as accurate and as cost reflective as the data on which it is based. It is unlikely that this can be a truly economic and efficient substitute for prices that are set as a result of economic and efficient balancing of the system by Transco".

Dynegy argues that harsher penalties for an end-of-day imbalance beyond the SAP tolerance band should create conditions where market participants are reluctant to behave in ways that increase the risk of such an imbalance. There is therefore a case for suggesting that a wider SMP buy-sell spread could discourage the profiling of gas throughout the day. This may in turn improve liquidity on the OCM. However harsher penalties are unlikely to discourage the behaviour of those with precise control over their end-of-day balance and hence it is not clear how much of an improvement we can expect. In deciding whether to support this modification we have had to consider whether the disproportionate impact this modification will have on shippers without precise control is worth what could be a very slight improvement in profiling within-day. Dynegy supports the proposal.

Powergen supports the objectives of this proposal, but does not like the specific marginal price calculation proposed. Whilst agreeing with the proposer that setting system marginal prices (SMP) at levels which are invariably different to system average prices (SAP) is desirable to provide further incentives on shippers to balance. The combined impact of Transco's dominance in the OCM and its current policy to avoid balancing actions wherever possible has on many days resulted in SMP prices being set only on one side. This has given more scope for shippers to choose to take the cash-out price rather than trade-out their positions. Any approach that maintains a differential between SAP and SMP is therefore a good thing as it avoids such asymmetry in cash-out prices.

Scottish Power supports this modification. It believes that the current arrangements provide little incentive for shippers to balance, and that ensuring a SAP/SMP differential on all gas days will provide a limited inducement. It shares the concerns expressed by the workgroup over the possibility of price inversion and hence support the modification as clarified at the recent RGTA meeting and in writing. Scottish Power does not see this proposal as a particularly strong solution and support the ongoing discussions within the RGTA forum looking at further changes to the cash-out regime and Transco incentives. For example, it does not believe the issue of shipper overdelivery due to a high SAP will be addressed by this modification.

EnMO supports the objective of the proposal, if the industry requires a rule-based solution. EnMO believes that the creation of a permanent differential between SAP and SMPs is likely to improve shipper balancing behaviour. To this end, EnMO endorses the principle of defining a band around SAP within which SMP_{buy} and SMP_{sell} could not encroach. EnMO believes that it is important that Transco action continues to contribute to SMP's when its traded prices move outside this band, because cashout prices then reflect the true cost of imbalances to the system.

Innogy is supportive of the modification proposal. It agrees that the cash-out regime should be modified such that differential cash-out prices are set each day. It believes that this will incentivise shippers to trade out their imbalances rather than retaining them, as it should always be better to trade in the market rather than face a possibly extreme marginal price.

Scottish and Southern Energy (SSE) states that whilst it agrees that "it would be desirable for there to be a SMPBuy/SMPSell spread", it does not support "moves away from cost-reflectivity and back to more penal incentives by arbitrarily forcing a spread between buy and sell prices. Introducing a mechanism as proposed *might* encourage shipper balancing, but is unlikely to improve cost targeting".

AGL is doubtful whether this proposal will prevent or significantly reduce within day profiling. It believes that those shippers with the ability to profile, as they have access to swing gas are unlikely to change their behaviour as a result of this modification. Indeed it may provide additional incentives to take positions. AGL is concerned that if implemented, this modification may increase risk and therefore impose greater costs on smaller players without significant levels of within day flexibility. Shippers that have the ability to profile are to a great extent protected by their ability to get themselves back into balance for the end of the gas day.

Northern Electric & Gas Limited (NE+GL) does not believe that the most effective way in which to control end of day balancing actions is to create a difference between SMP and SAP. This proposal would introduce unrelated penalties to what should be a system which reflects market fundamentals on the day.

Shell Gas Direct does not support this modification. It considers that it would result in inefficient prices that are not reflective of the supply and demand for gas on a particular day. It argues that the SMPs on a day often reflect particular events such as increased demand or supply failures. Those prices provide some immediate signals to Transco and shippers and are specific to that day's events. Shell believes that it would be inappropriate to put in place a regime that had the effect that high prices on a particular day could result in unusually and inefficiently high prices for each day in the following week.

Aquila argues that "a cash out regime should have two objectives: to recover the cost to the system of shipper imbalance and to provide a clear incentive for shippers to be in balance. Thus, the differential between SAP and SMP should reflect the true costs to the system of imbalance on each and every day. At the same time, SMP cash-out needs to be regarded as a "penalty payment". Modification Proposal 420 does not fulfil both of these criteria. By taking the "highest of marginal buy or 7-day average SMP, modification 420 would certainly be a penalty payment but would not be in any sense a “fair” price reflecting the true costs of imbalance".

Transco response

Transco has previously argued that shipper balancing does appear to be significantly influenced by the asymmetrical incentives on days when Transco balancing action has taken place on only one side of the market. Transco has presented evidence of days where the System balance has changed in response to commercial signals and that this switch has occurred too late in the day for Transco to reasonably undertake a commercial counter action. The introduction of a 'default' SMP would provide a degree of moderation to the incentives to 'follow an attractive SAP'.

Some shippers have suggested that SMP cashout prices should only be set by Transco balancing actions but in support of the principle of having SMPs set on both sides of the market it has been suggested that Transco should take action to both buy and sell gas regardless of the apparent state of the System balance. This would then set both SMP prices for the day. Transco considers that the proposal represents a more sensible option than introducing an obligation for Transco to take potentially unnecessary market actions.

Alternative approaches to determine SMP

V-is-on is convinced that the original proposal best allows system prices to relate to the market prices. It notes that "the volatility approach has a similar impact, but may over exaggerate the spread in an already illiquid market. V-is-on is also concerned that the System Weighted Average Marginal Price (SWAMP) could be open to manipulation and that "to allow shipper trades to set prices also moves away from the idea of identifying the "cost to the system" of Transco's balancing actions".

Shell Gas Direct considers that all of the alternatives discussed in recent workstreams are inappropriate and would be "likely to lead to prices that are inefficient and not reflective of the market conditions on a particular day. For example, models based on the previous seven days volatility or which create an absolute fixed difference between marginal and average prices will distort the market and provide inappropriate signals". Shell also considers the SWAMP option as problematic as although it is related to a particular days market conditions it is likely "to encourage and reward - particularly in such an illiquid market - trades that are taken contrary to the prevailing market conditions."

EnMO made a response that included analysis to support the conclusions that it had reached. EnMO does not believe that the proposal achieves the intended objective and that other alternatives exist which would better achieve it. In particular, the most effective approach would be to define a simple band around SAP within which SMP_{buy} and SMP_{sell} could not encroach, preferably specified in terms of an absolute value, or alternatively in terms of a percentage of SAP. Coincidentally, such an approach would allow much faster implementation within Transco and Shipper systems, as well as within the Altrade Trading System.

The approach proposed would generate a significant number of days, perhaps over 20% of days, on which SAP is equal to either SMP_{buy} or SMP_{sell}. This therefore appears to fail to achieve the objective of setting differentials on all days. Because it uses absolute historic data, the approach would also generate significant differentials between SAP and SMP's on days when there appears to be no market driver for such a differential, in particular when there is a step-change in price after a period of price stability.

Overall, EnMO believes that the proposal is not the most efficient at meeting the objective, and generates cashout prices that are not necessarily cost-reflective or reflective of prevailing market conditions.

BGT argues that the proposal is flawed because even if the SMP is set to SAP on days where the differential between them is in the wrong direction it would not provide an incentive to balance for shippers since all imbalances in the relevant direction would be cashed out at SAP regardless of whether the imbalance was within tolerance levels.

BGT does not favour SWAMP. It recognises the argument that such an approach is reflective of the market fundamentals on the day, subject to an arbitrary 10%, but considers that there are two issues that must be addressed. "First, it will be necessary to negate any benefit flowing to a shipper that trades with Transco on the OCM at a more advantageous price - to the shipper- than SWAMP, and profits by not performing the Transco trade and being cashed out at SWAMP.

Secondly, if Transco act in the market in one direction it is feasible that the SWAMP based SMP on the side where there has been no action may be set at a level which does not provide a sufficient incentive for shippers to balance. For instance on a day where Transco buys gas at a range of 20-25p per therm the SWAMP calculated SMP buy could be at 23p whilst the SMP sell could be at 21p. In this instance a shipper could be incentivised to take an imbalance position outside tolerance levels in order to receive SMP sell cashout at 21p. Although it could be argued that a shipper would be incentivised to trade out its long position at closer to SAP, which could be at 23p, this view assumes that for every long position there is an equal short position. With prices at relatively high levels, in excess of 20p, it is more likely that shippers would tend to be long in order to take advantage of the cashout price."

BGT considers that the volatility approach offers the most suitable solution.

AGL believes that the volatility proposal could provide the greatest incentive on shippers to balance and potentially reduce Transco's balancing actions. It is of the view that the period over which, the volatility measure should be derived should be a short period which reflects the 'real' duration of extreme prices on the succeeding days. On this basis it proposes that the average percentage differential over a rolling 3 day period should be used in order to minimise the effects of any extreme days.

Powergen expressed a preference for the (Minimum) Fixed Differential Approach to cashout with SMP_{buy} set at the greater of 120% of SAP or the highest offer price accepted by Transco. This provides minimum shipper balancing incentives on all days and an appropriately stronger response related to market conditions on days when the system is under stress.

Powergen strongly opposes the System Weighted Average Marginal Price (SWAMP) approach as this would fall to provide shippers with sufficient incentive to balance when the system is under stress. Any damping of prices through a an averaging of the top x% of accepted bids would significantly 'water-down' such an incentive.

Yorkshire Energy consider that the most appropriate method should be that suggested in the original proposal including the "higher of" rules detailed in the letter. The other methods proposed all involve the use of arbitrary parameters, which we feel should be avoided if possible. The method used to set the SMP should be simple to calculate and use data relevant to that gas day only.

TXU believes that the best methodology to use for calculating SMP would be the Volatility based approach, using standard deviation as the measure of volatility. The volatility method would be best used in conjunction with the highest "Market offer price", so that a derived price would only be set on days when SMP was not set by the market.

Transco Response

Implementation of the proposal would deliver a differential in SMP cashout prices on many more days than under the current regime. The SMP prices determined by the method proposed would on most days be set at differentials to the SAP. However, the analysis provided by EnMO indicates that had this approach been applied historically there might have been approximately 20% of days where the calculated SMP would be set equal to SAP. Despite this shortcoming, Transco is persuaded that the proposal represents an improvement to the regime.

Transco encouraged respondents to comment on three alternative options in addition to the original proposal. Transco notes that there was no consensus in the representations on which option offered the best solution. Previous proposals have been based on a permanently fixed differential about the SAP. The original proposal, based on a rolling 7 day average of the respective SMPs would deliver a solution that is clearly more market related as the prices are derived from the market albeit on a retrospective basis. The other variants based on historic analysis may also be argued to be 'market prices'. However, there appears to be considerable concern regarding the 'lock in' effect of days with price spikes. The SWAMP approach may be argued to be the only option that provides SMP prices that are directly related to gas values on the day. However, this alternative was also criticised as the price derivation would be based on trades conducted on the OCM.

Transco is inclined to agree with many of the respondents that none of the options discussed present a perfect solution. However, Transco is of the view that the proposal would present a step in the correct direction and would contribute to an improvement in System balancing. Therefore, Transco believes that it is appropriate to implement this proposal and Transco will be willing to undertake further debate with the industry to define a better long term solution.

Interaction with other modifications

Aquila urges the shipper community to adopt a wait-and-see policy in regard to cash out. It argues that "changes to the cash out regime may be necessary, but any proposals should be made once the effects of the October tolerance reductions are understood. Cash-out is an important element of the balancing regime and deserves careful attention, a considered Ofgem consultation paper would be more appropriate than ad hoc modification proposals."

AGL is not supportive of this modification as it does not believe that it is appropriate to change the cash out regime at this time. "Following the implementation of

Modification 0415, and whilst awaiting Ofgem's forthcoming document on future developments to the energy regime, it seems inappropriate to implement changes to a cash out regime which is likely to change from April 2001 when balancing tolerances are removed. It would seem more prudent to wait and assess the impact of the reduction of balancing tolerances and the implementation of NETA before the industry has to implement another change to the existing energy regime. The ongoing nature of such piecemeal changes is of significant concern as modifications are being implemented before the industry has had the opportunity to fully review the impact of previous reforms."

NE+GL argues that if it is Ofgem's intention to introduce a fundamental obligation to balance (as opposed to commercial incentives to balance) then these changes should be through licensing conditions. NE+GL believe that if Transco were to follow more mechanistic rules regarding balancing there would be less opportunity to gain from remaining out of balance.

Dynegy states that although it is in favour of this modification there are a number of caveats:
- This modification cannot solely improve within-day balancing behaviour. Other measures include removal of tolerances and a narrower symmetrical tolerance band for Transco, outside of which it takes balancing actions.
- Whatever set of rules are in place, they cannot prevent the exercising of market power. The best way to dilute market power (and to deal with any suspicion that it is being exercised) is for far greater transparency in within-day information.

Shell Gas Direct urges a more pragmatic and considered assessment of where changes can be justified. It suggests that a more holistic approach would also be more appropriate. It notes that Ofgem has only recently agreed to reductions in the balancing tolerances.

TotalFinaElf states that it "would happily consider a suite of proposals which collectively and consistently tackle the issue of reducing balancing costs, however, the current piecemeal approach will only lead to the creation of additional problems which will further cloud the process of resolution identification".

SSE is aware that Ofgem has indicated that it is due to publish a paper imminently proposing further amendments to the energy regime. It suggests that to change the cashout regime without first waiting to see the impact of the reduction in tolerances or the proposals for the longer term development of the regime would be imprudent at this stage.

Transco response

Transco notes the concerns regarding the interaction between this proposal and others that also affect shipper balancing incentives. However, Transco is of the view that the narrowing of balancing tolerances effected by Modification Proposal 0415 will only go part way to ensuring that shippers face consistently enhanced incentives to balance. The risks presented to the System as a result of a within day switch from short to long balance will remain unless the commercial incentives are modified. Transco has raised particular concerns about the within day linepack variations that have resulted from the aggregate effect of this shifting of imbalance position. Transco acknowledges that the development of solutions to the within day issues will require industry consideration and debate and that this may take some time. However, Transco believes that enhancements that are made to the end-of-day incentive mechanisms may also encourage better within-day balancing.

Transco is sympathetic to the views that the changes that have recently been implemented and proposed have been somewhat piecemeal. However, Transco is of the view that although this proposal may not offer the best solution to current inefficiencies in the balancing regime it is a move that will further promote achievement of the relevant objectives. Transco would be willing to participate in any debate that sought to develop the balancing regime to deliver more efficient cost targeting with appropriate incentives for both Transco and shippers.

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

Not applicable

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

Not applicable

14. Programme of works required as a consequence of implementing the ModificationProposal

A programme of works is not required

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

The proposal requests implementation as soon as possible. However, Transco recommends that in order to provide shippers with some notice of implementation and to allow time for the necessary system changes to be made that the revised regime should apply from no earlier than 1 October 2000.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this proposal (as amended by agreement with the proposer to remove the potential for a price anomaly) be implemented to have effect from 1

October 2000. Such implementation would modify the mechanism to determine System Marginal Prices to be used in the Imbalance Cashout regime.

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

SECTION F: SYSTEM CLEARING, BALANCING CHARGES AND NEUTRALITY

Amend paragraph 1.2.1 to read as follows:

"Subject to paragraphs 1.2.2 and 1.2.5, for each Day:

(i) the "**System Marginal Buy Price**" is the higher of:

(a) the System Average Price;

(b) the System Average Buy Price; and

(c) and the price in pence/k Wh which is equal to the highest Market Offer Price in relation to a Market Balancing Action taken for that Day;

(ii) the "**System Marginal Sell Price**" is the lower of:

(a) the System Average Price;

(b) the System Average Sell Price; and

(c) and the price in pence/k Wh which is equal to the lowest Market Offer Price in relation to a Market Balancing Action for that Day;

(iii) ….

(iv) the "**System Average Buy Price**" is the arithmetic mean of the System Marginal Buy Price for each of the preceding 7 Days; and

(v) the "**System Average Sell Price**" is the arithmetic mean of the System Marginal Sell Price for each of the preceding 7 Days.".

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

<u>Gas and Electricity Markets Authority Response:</u>

> 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 **0420**, version **2.0** dated **12/09/2000**) 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 <u>(whether such approval is actual or deemed by effluxion of time)</u> 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, <u>had it not been repealed, would</u> 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) <u>or 2(2)(b)(ii)</u> 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.