

Modification Report
Avoidance or correction of shipper errors in purchasing and selling entry capacity
Modification Reference Number 0419
Version 1.0

This 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

The error management arrangements described below are intended to make a clear distinction between monthly 'blind' auction processes where bids are processed at a fixed time and the daily processes characterised by dynamic competitive re-pricing and variable bid/offer acceptance times. The former process is a more controlled environment in which the 'unwinding' of transactions is more difficult because of the impact such 'correction' procedures may have on any auction result. Consequently, this modification proposal does not propose manifest error 'correction' procedures for monthly auctions.

The daily 'capacity flexibility' processes however, are more akin to other screen-based commodity trading systems in which individual trades between counter-parties provide for the possibility of amendment in exceptional circumstances. Transco may choose to process many trades sequentially but this cannot be described as an 'auction' mechanism. It is simply a collection of individual transactions processed at the same time. 'Unwinding' one trade does not impact on other shippers as Transco can simply go to the market again to make up any resulting shortfall.

Shipper Error Avoidance

This proposal requires Transco to develop its system to provide optional volume and price warning limits when shippers enter data onto the RGT A system. System validation with values of parameters set by shippers should as a minimum include:

'Upper and lower bid/offer price limits.

.Upper and lower bid/offer volume limits.

.Upper and lower % tolerance limits from the last trade price*.

(Last trade price being the lowest price transaction when Transco sequentially accept a series of bids/offers)

.A display of the price of the last trade*.

* Applies to daily capacity products only and would be similar to the 'last trade' displayed on EnMO OCM screens.

It is intended that detailed proposals would be developed within the relevant Network Code Workstream.

Shipper Manifest Error Correction

(Applies to daily capacity only)

It is proposed that manifest error provisions similar to those operated by EnMO on the OCM, would be applied by Transco. These would provide for shippers to request a trade to be 'unwound' within [10] minutes of a bid or offer being accepted by Transco. In making such a request the shipper in question would have to pay a non-returnable 'administration' fee of [£5,000] for each request to have a trade voided.

Transco would establish "Manifest Error Guidelines" describing typical circumstances under which Transco would declare a shipper trade void. Subject to these guidelines Transco would at its discretion void a trade within [10] minutes of a shipper submitting a manifest error request. For the purposes of Transco's Price Control, non-returnable 'administration' fees would be treated as normal transportation revenue.

[] Suggested values.

2. Transco's Opinion

For the purposes of considering this proposal Transco has identified two distinct parts; bid validation and manifest error provisions. However, Transco does not believe that either the bid validation functionality or manifest error provisions should be captured within the Network Code although discussion of this proposal did provide a vehicle for consideration of the enhanced features that Users would like to see made available in the RGTA systems.

Bid Validation

Transco has agreed to proceed with development of bid validation functionality in parallel with discussion of this modification proposal. Transco does not believe that the provision of this functionality should form part of the Network Code but would assist shippers in the use of the RGTA capacity auction system. Discussion of the proposal in the workstream meeting was used to form the detailed systems specification.

Maximum price of bid

Transco agreed to provide this functionality

Minimum volume and minimum price criteria

Transco agreed to provide these limits.

Display of last traded price and validation on percentage deviation from this price.

Transco identified that the architecture of the RGT A system would not support a 'real time' update on screen of this value. The system has been built to accept bids into a database and to publish results following a batch processing. Screens are not updated automatically although by requesting a 'refreshed' view of the database shippers can see auction results.

The proposer agreed that it would be prepared to remove this element from the proposal

Transco confirmed that the requirement for last traded value and the validations based on deviation from this value would not be included in the proposed system specification.

Summary of functionality specification.

(In addition to Maximum volume and Maximum value of bid (delivery with MISEC auction))

Maximum Price of bid, (p/kWh)

Minimum Volume of bid, (kWh)

Minimum Price of bid, (p/kWh)

Shippers using a 'supervisor' security level will set validation limits and it will not be possible for 'traders' to amend the limits.

There will be only one level of validation and this will provoke a warning message that must be acknowledged before the bid can be committed to the database.

No default validation parameters will exist.

Shipper validation parameters will not be checked against system limits (e.g. minimum bid volume of 100.000 kWh or reserve prices).

Validation tests will only be applied to bids being entered to the screen and cannot be applied retrospectively to bids already held in the database. i.e. if validation limits are changed the system will not test bids that are already held in the database against the revised criteria.

Manifest Error Provisions

Transco believes that the RGT A capacity system is an auction tool and is not a trading system like the OCM. Transco has argued that the manifest error provisions provided for the OCM would not be appropriate in the context of the capacity allocation regime. The capacity allocation is a batch auction process and the outcome of the auction is dependent on the content of the whole bid stack. The proposer argued that individual transactions could be voided within the daily process without impacting on other parties if the capacity allocation process is considered as a series of discrete bilateral trades. If a single trade is declared void the capacity could then be allocated to another bid.

Transco stressed that bids are not considered independently and in the case of bids with equal price there may be scaling of allocations so that other shippers may be affected. If a bid has been affected by scaling then the 'unallocated' part of the bid is discarded. In the case where the scaling would give an allocation that is less than the

shipper's stated minimum quantity then the whole bid is ignored in that auction run. Therefore, the removal of a bid after processing could significantly affect other bidders.

The presence of manifest error provision and an ability to withdraw from a capacity transaction might lead to concerns regarding 'gaming' of the capacity market. However, the application of an administration charge might offset any potential gains. A charge of £5,000 was suggested although the treatment of any revenues was not decided. Charges might be retained by Transco as an 'excluded' service or be considered as capacity incentive revenue.

It was agreed that manifest error could only be claimed against an allocation that had actually been made and would not apply where a shipper had failed to obtain capacity in an auction. For example, in the case of capacity purchases manifest error might only apply if the volume accepted was too large or the price too high. In the case of capacity surrender, manifest error might only apply if the volume was too large or the price too low.

Manifest Error Guidelines

The practicalities of unwinding a capacity allocation in a short time after processing implies that Transco might be the only party able to perform this role. Transco would be extremely uncomfortable acting as an arbitrator in deciding whether to void capacity allocations. Transco is a counter-party to every transaction and has a financial interest through the incentive mechanism. The Transco incentive mechanism is aligned with the interests of MSEC holders and so Transco would be acting on behalf of all MSEC holders. Transco has stated that it would require very prescriptive Manifest Error Guidelines if it were placed in the position of being the arbiter of manifest error and would be very uneasy about being expected to apply discretion.

The proposer described some criteria that might be applied to identify a manifest error. For example, a volume limit could be set as 25% of the 1 in 20 peak day flow at an ASEP. However, this would not necessarily be appropriate at monopoly ASEPs (Barrow is not the only example). An alternative volume limit could be 2 times the bidding shipper's maximum A TLink nominated quantity at the ASEP in the last 12 months. A price limit for bids could be set at 20% above the highest bid price accepted in the day or in the previous 6 days. A price limit for offers could be set at 20% below the lowest offer price on the day or in the previous 6 days. Transco has expressed grave concerns over the complexity of attempting to maintain availability of such data.

Alternative solution

The proposal does not intend that manifest error provisions should be applicable for MSEC and daily interruptible capacity processes. The features that distinguish these processes as different from the within day processes are a fixed closure to the bidding window and a batch processing of bids. There is agreement that these characteristics define these processes as auctions.

Throughout the development of RGTA Transco has stated that it would welcome the development of a screen based, anonymous, financially cleared capacity trading system. Transco has delivered systems consistent with this and argued that it was the intent of the within day capacity release to operate at fixed times through the day rather than operating as a fully dynamic trading system. The RGT A system has been built to support a batch processing function consistent with this intent. However, whilst the intent may have been to process at fixed times the Network Code does not oblige Transco to do this. In practice a manual intervention is required to initiate processing and so within day allocations have been run at times close to a whole hour but the exact time of processing has been variable.

Transco has proposed Network Code Modification 0432 that would introduce specific gate closure times for the within day capacity releases. This would remove the problem of uncertain closure to the bid window. For example the bid window could be closed on the hour and this would provide a clear time limit for competitive bidding. Shippers could amend or withdraw bids up until this time with certainty that bids would not be taken and so validation processes could be performed. Transco believes that modification proposal 0432 provides a better solution and may be viewed as a pragmatic alternative to this proposal.

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

Implementation of shipper bid validation would reduce the potential for bids to be accidentally entered to the RGT A system. This would reduce risk for shippers and may facilitate greater competition in the capacity markets, as shippers would have greater confidence that bid parameters correctly reflect their intentions.

Supporters of a manifest error provision argued that such measures would facilitate competition by removing some risk of errors and would also improve the efficiency of the capacity market.

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

a) implications for the operation of the System:

There are unlikely to be any implications for the operation of the System. The proposal for manifest error provisions affects the daily capacity auction processes.

b) development and capital cost and operating cost implications:

The implementation of capacity bid validation would require some changes to RGT A systems. If manifest error provisions were to be implemented then these would require additional system changes and new procedures within Transco to facilitate a rapid processing of any requests for a transaction to be nullified.

Transco intends to introduce some bid validation with the installation of the MISEC auction functionality. Further bid validation will incur development cost but minimal operational costs.

The introduction of manifest error provisions would incur system development costs and in addition would lead to operational costs maintaining procedures and training so that staff are able to respond to manifest error claims in a timely manner. In addition, operational costs would be incurred for each operation of the manifest error procedure.

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:

Costs of system development would be met from allowed revenues for such purposes. It may be appropriate to introduce a charge for the operation of any manifest error provision, as suggested by the Proposer.

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

No such consequences have been identified

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

Transco believes that the implementation of shipper bid validation functionality could reduce the likelihood that shippers will post bids in error and subsequently contest invoice amounts.

Transco believes that the implementation of manifest error provisions would significantly alter the nature of Transco's role in the capacity allocation process. Transco is concerned that as a counter-party to all capacity allocations it may have conflicting responsibilities if it is required to act as arbiter of manifest error occurrences.

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

The provision of bid validation has been previously considered and some functionality was provided from mid November 2000. Further bid validation will be developed as defined by the workstream with an anticipated delivery date of Spring 2001. Bid validation will require the introduction of some new input fields on the RGT A system but will not require the change of any hardware systems.

Implementation of manifest error provisions would require a mechanism for shippers to notify Transco that a bid is in error. This could be provided for by a mechanism outside the RGT A system but might be better achieved by introduction of a specific facility within RGTA.

The ROTA system would require modification so that a single bid could be rapidly excluded from the processed bid stack and the auction results revised appropriately. It would be essential to provide a rapid resolution of any manifest error claim to minimise the effects of a spurious allocation on capacity and other markets.

At present, bid removal requires direct intervention by the RGT A computer system manager to overwrite database tables. This cannot be achieved quickly as the processes are manual and significant effort is required to create duplicate tables to preserve an audit trail of changes made to database tables. Therefore, some significant system development might be required to provide operators with a robust mechanism for management of manifest errors.

7. The implications of implementing the Modification Proposal for Users

The implementation of bid validation would assist Users by enhancing the process for input of capacity bids. Some minor changes to shipper administrative procedures would be required. Users would have a choice whether to input validation parameters.

Introduction of bid validation functionality would reduce the potential for bids to be incorrectly entered into the RGT A system. This would reduce the likelihood that shippers are allocated capacity at a price or volume that was not intended. Thus the level of commercial risk would be reduced.

Implementation of manifest error provisions for the within-day auctions would provide a facility for users to request the unwinding of a within-day capacity trade that has been entered into in error or would permit an opportunity for a shipper to appeal against a within-day capacity allocation if such an allocation is the result of a bid being accepted that was posted in circumstances of manifest error. This would permit a within-day capacity allocation to be unwound so that the shipper would not be liable for the relevant capacity charges or would not be obliged to make a within day capacity surrender pursuant to the bid. Users would have to establish mechanisms to submit to Transco a request for the application of the provisions within the timescale allowed.

Implementation of manifest error provisions might lead to some increased uncertainty in the period immediately after a within-day capacity allocation. This would arise because the results of the allocation would have to be considered provisional until such time that any possibility of an allocation being unwound was passed.

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 consequences have been identified

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

Implementation of this proposal would place an additional responsibility on Transco to act as arbiter in the case of a shipper declaring manifest error. This proposal does not provide a corresponding provision for Transco to declare a manifest error.

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

Advantages.

Definition of bid validation functionality

Provides a mechanism for unwinding within day capacity bids placed through manifest error

Disadvantages.

Administrative complexity

Potential for 'gaming' increased

Very prescriptive Manifest Error guidelines required

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 Shell Gas Direct, Powergen, Scottish and Southern Energy, TXU Europe Energy Trading and British Gas Trading. Two respondents did not support the proposal. Of the three respondents in support of the proposal one was the proposer, Powergen.

The proposal was considered to have two distinct parts; facilities for bid validation upon entry to the RGT A system and provisions for manifest error following acceptance of an erroneous bid.

Shipper bid validation

Shell Gas Direct supports the proposals to include mechanisms by which shippers can validate their bids, adding that it would be envisaged that these systems would be similar to those in place on the OCM and operated by EnMO.

Scottish and Southern Energy (SSE) believes that the provision of bid validation functionality would encourage shippers to participate in the capacity markets, in the knowledge that keystroke/operator errors would be picked up before a bid or offer is posted on the RGTA capacity system. However, SSE is uncertain as to whether it is necessary for the bid validation functionality to be included in the Network Code as it would form part of the RGTA capacity system.

BGT does not believe it to be appropriate for the Network Code to contain formal bid validation requirements for the sole use of shippers. Providing risk management services for shippers should not be the function of the Network Code. Furthermore, BGT notes that Transco has responded to requests from shippers to incorporate optional validation limits into the RGT A system without the need for a Network Code change. BGT would support the further development of these bid validation facilities but this should be on the basis of a service offered by transporter to shipper rather than a formal contractual requirement.

Manifest error provisions

BGT does not agree with the Proposer's view that the daily capacity mechanism is "simply a collection of individual transactions processed at the same time" and that a voided trade would have "no impact on other shippers". This view does not appreciate the dynamic nature of the capacity market in which shippers compete to have bids accepted. For instance, if Transco were to void a transaction there is no guarantee that going to the market again would result in the next shipper in the bid stack, at the time of the initial allocation of capacity, being successful as their bid may have become less competitive due to the repricing of other shipper bids.

BGT reiterates that there are fundamental problems with allowing a counter-party to all trades to be the sole arbiter of whether a trade may be a valid manifest error. This is particularly relevant when Transco's current capacity incentive is based on the revenue through daily sales of capacity. BGT is concerned that shippers are being asked to agree to this principle with the comfort that Transco will develop "Manifest Error Guidelines" which are not currently defined in any way.

SSE agrees with Transco's reservations about using its discretion when assessing manifest error claims. With Transco as the counter-party to each transaction on the RGT A capacity system SSE does not think it appropriate that Transco should have discretion as to whether or not a trade should be voided. Transco's role also needs to be clear given the context of the current capacity incentive. It argues that before the service is introduced it would be important that clear and robust 'Manifest Error Guidelines' are developed explaining exactly how Transco would deal with such claims by shippers. This is particularly important given that daily capacity transactions are incorporated into the calculation of overrun charges and will therefore influence shippers' valuation of capacity.

Shell Gas Direct stresses that the administration charge for invoking the manifest error procedures must be sufficiently high to ensure that it is only used when genuine manifest errors occur and not purely because a shipper would wish to re-assess the price of their bid. Shell Gas Direct also notes that Transco must be confident that it can operate to the timescales required by any manifest error procedures and that it would have available all the necessary information to exercise a proper judgement on one or more manifest error situation.

Powergen draws attention to the discussions and consultations taking place under NET A and urges for similar "manifest error" principles to be applied in both the gas and electricity markets.

While TXU Europe Energy Trading Ltd (TXU) welcomes the discussion of manifest error provisions within the daily capacity auctions it feels that it cannot support this modification proposal as the manifest error provisions discussed in the proposal do not set out exactly what they would be or how they would be applied. TXU feels that as no manifest error guidelines have been produced prior to the modification proposal going to consultation it cannot support this modification proposal.

Transco opinion

Transco welcomes the support of respondents to the view that bid validation should not form part of the Network Code. Transco has consulted with shippers to define requirements for bid validation and has commissioned system development to provide new functionality. Transco believes that functionality to provide bid validation is an enhancement to the ROTA system but that it should not form a contractual obligation. If detailed bid validation facilities were constrained by contract it might inhibit the ability of Transco to respond to further requests to provide improvements to services as these would require Network Code modifications.

Shippers voiced concerns that a significant factor that could lead to manifest error is uncertainty regarding the time at which Transco processes capacity bids within the gas day. Transco has made modification proposal 0432 to

compliment this proposal. Implementation of modification proposal 0432 would introduce a fixed window for bid entry and would mitigate many shippers' concerns regarding the uncertainty of bid acceptance. A fixed bidding window would permit further validation of bids entered by shippers and therefore significantly reduce the probability of manifest error.

Transco acknowledges shipper concerns that a bid placed in error might be accepted and a shipper might then face an unexpected capacity charge. However, Transco has concerns that there is insufficient definition of manifest error and considerable uncertainty regarding the practicality of Transco acting as arbiter of any manifest error claim. Transco does not accept the arguments that the RGTA capacity allocation system is the same as a trading system and that similar manifest error provisions are therefore necessary.

Transco believes that before any provisions for manifest error in capacity bids are introduced the appropriateness of such a move should be considered carefully.

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 3(5) or the statement furnished by Transco under Standard Condition 3(1) of the Licence

Not applicable.

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

System changes have been requested to provide the bid validation functionality as specified by a development workgroup that met on 20 September. Delivery of this enhanced RGTA system functionality is expected in Spring 2001.

The provision of manifest error provisions would require significant system development to permit timely removal of a single bid from a bid stack that has been processed. Additional audit routines would be required within the system to ensure that the status of each bid could be tracked through the initial and the revised processing of the bid stack. If manifest error provisions are implemented then an initial assessment of system impact implies that a period of five months would be required between agreement of functionality and installation of tested code.

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

Transco does not recommend implementation of this proposal.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not recommend implementation of this proposal.

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.

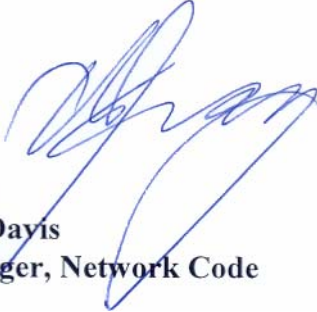
18. Transco's Proposal

This modification Report contains Transco's proposal not to modify the Network Code and Transco now seeks agreement from the Director General in accordance with this report.

19. Text

No legal text has been provided as Transco does not recommend implementation of the proposal.

Signed for and on behalf of Transco.



Davis
Manager, Network Code

Signature:

Date: 28 DECEMBER 2000

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 **0419**, version **1.0** dated **28/12/2000**) 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 **1.0**.

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.