URGENT Modification Report
Review of Entry Overrun Charges
Modification Reference Number 0408

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 Transco believes that it may be appropriate for the present overrun regime to be amended. If a change to the overrun calculation is to be implemented it is most appropriate that the basis of new calculations should be known to users prior to formulating bid strategies for the next series of Monthly System Entry Capacity auctions and therefore urgent procedures are requested.

Procedures Followed:

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

Issue to Ofgem for decision on urgency	19 June 2000
Proposal agreed as urgent	21 June 2000
Proposal issued for consultation	21 June 2000
Close out for representations	11 July 2000
Final Report to Ofgem	18 July 2000
Ofgem decision expected	21 July 2000

1. The Modification Proposal

The proposal contemplates revising the entry capacity overrun charge to take account of whether or not a “constrained day” has been declared at any terminal . For the purpose of the modification proposal, a “constrained day” is defined as one on which all interruptible capacity at that terminal has been interrupted and Transco has subsequently taken a buy-back of firm capacity at the same terminal and on the same day.

The proposal also seeks to remove the day ahead gate closure, such that the revised overrun calculation would take into account capacity prices within the gas day.

Where an entry terminal is non-constrained, it is proposed that the overrun mechanism would be revised such that the energy component (the lesser of 1.5 x SAP or 0.6054 p/kWh) does not apply in the calculation of the overrun charge. Where an entry terminal is declared “constrained”, the overrun charge would be calculated in accordance with the present Network Code rules. Experience to date suggests that this proposal would result in a significant reduction in the overrun charge on non-constrained days.

On “constrained days”, the calculation for the proposed overrun charge would remain as set out in Section B 2.10 of Network Code as follows :

The System Entry Overrun Charge shall be calculated as the amount of the overrun quantity multiplied by whichever is the greatest of:

(i) (1.1 * A), where ‘A’ is the highest offer price pursuant to any daily capacity offer which was accepted by Transco in respect of the Aggregate System Entry Point for the Day;

(ii) (8 * B), where ‘B’ is the Applicable Daily Rate determined in accordance with paragraph 2.9.3(ii) for Monthly System Entry Capacity at the Aggregate System Entry Point for the calendar month in which the Day falls;

(iii) (1.1 * C), where ‘C’ is the highest bid price pursuant to any daily capacity bid which was accepted by Transco in respect of the Aggregate System Entry Point for the Day; and

(iv) the lesser of:

(a) (1.5 x D) where ‘D’ is the System Average Price for that day; or

(b) E, where ‘E’ is 0.6054 p/kWh.

On “non-constrained days”, the proposed overrun charge would be calculated as follows :

The System Entry Overrun Charge shall be calculated as the amount of the overrun quantity multiplied by whichever is the greatest of:

(i) (1.1 * A), where ‘A’ is the highest offer price pursuant to any daily capacity offer which was accepted by Transco in respect of the Aggregate System Entry Point for the Day;

(ii) (8 * B), where ‘B’ is the Applicable Daily Rate determined in accordance with paragraph 2.9.3(ii) for Monthly System Entry Capacity at the Aggregate System Entry Point for the calendar month in which the Day falls;

(iii) (1.1 * C), where ‘C’ is the highest bid price pursuant to any daily capacity bid which was accepted by Transco in respect of the Aggregate System Entry Point for the Day.

2. Transco’s Opinion

The present entry capacity overrun regime, introduced in October 1999 within RGTA, has provided an incentive to shippers to book entry capacity. However, since its introduction, it has been argued that since the level of overrun charge has been high that it may have limited shippers' gas sourcing choices on days when the system may have physically been able to accomodate gas flows under a different supply configuration.

The modification proposal seeks to revise the overrun charges to a level that will continue to support the “ticket to ride” principle, but will not appear to unduly restrict the amount of gas made available to the system.

The proposed overrun charge mechanism should also discourage the hoarding of surplus capacity, and thus may improve the liquidity in capacity trading . The proposal also intends to improve cost-reflectivity by taking into account capacity prices resulting from the recently introduced within day capacity release mechanism, and shippers should face overrun charges that more closely reflect the commercial consequences of the community's valuation of capacity at specific points on the system.

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

The proposed modification would facilitate competition in the UK gas market through improving liquidity in the secondary trading market. In addition, the proposal should encourage shippers to deliver additional gas to the system, and maintain an incentive on shippers to book capacity in the first instance, thus furthering the economic and efficient operation of the system. The proposal also intends to improve cost-reflectivity by taking into account capacity prices resulting from the recently introduced within day capacity release mechanism.

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

a) implications for the operation of the System:

The proposed removal of the energy component may reduce the level of overrun charges, in particular, on non-constrained days. This may 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 proposed removal of the energy component and the D-1 gate closure in the calculation of the overrun charges 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 may reduce the levels of firm capacity sales 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 would need minor changes to effect the removal of the D-1 gate closure so that the prices of any accepted capacity bids beyond the present gate closure are taken into account in the calculation of the overrun charges.

7. The implications of implementing the Modification Proposal for Users

Users would typically face a significant reduction in entry overrun charges, which may alter their view of the relative value of firm and interruptible capacity rights. Users may need to monitor "within-day" prices of bids accepted by Transco for daily capacity in order to guage an up to date position on the expected level of overrun charges.

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

A reduction in the level of overrun charges could reduce the 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) in the absence of any daily capacity buys and sells, the likely reduction in overrun charges may reduce the incentive on shippers to book entry capacity in the first instance

b) the level of overrun charges within day will not be as apparent to shippers as with the present regime, and hence shipper monitoring of the operation of the capacity release/buy-back mechanisms may be necessary to monitor shippers exposure

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

Transco received 17 representations.

Of these, the following twelve respondents express support for the proposals :

Agip (UK)

V-is-on

Yorkshire Energy

Alliance Gas

Powergen

Northern Electric

TXU Europe Energy Trading

Total Gas Marketing

Npower

Shell Gas Direct

BG Transco LNG Storage

Health and Safety Executive

The following four respondents do not express support for the proposals :

Scottish Power

BP Amoco

Centrica

Conoco

The following respondent gave no overriding view on the proposals :

Scottish & Southern

General

Many of those respondents expressing support for the proposals do so on the basis that the reduction in overrun charges on non-constrained days should encourage gas to be delivered on to the system and may help to persuade shippers to trade any surplus capacity.

PG supports the proposals providing no further reductions in the level of charges are proposed. V supports the principles but has concerns about the energy link and the systems for ensuring shippers can judge potential overrun charges.

BGT expresses the view that the proposal to introduce a reduced overrun charge on "unconstrained days" seems inconsistent with the position set out by Ofgem in its letter to the Industry dated 30 May 2000 , and if shippers are to be discouraged from overruning then the present regime should remain in force on all days. BGT further argues that the availability of the within day capacity market lessens the risk of shippers overrunning and therefore there is now less of an argument for reducing the level of overrun charges. Co argues that the proposed level of charges for "non-constrained" days remains unnecessarily harsh.

SP suggests that the overrun charge regime could effectively be removed if the availability of interruptible capacity is maximised and interrupted when necessary on "constrained" days.

Level and Component of Overrun Charge

Twelve shippers express support for the removal of the energy component in the calculation of the overrun charges on "non-constrained" days.

V suggests that the energy component should also be removed on "constrained" days, although three shippers (AGL,YE,NP) provide the opposing view that the energy component should remain for "constrained" days.

BP argues for a further reduction in the charges on "non-constrained" days by suggesting a reduction in the multiplier of the applicable daily rate from 8x to 2x.

SP argues that the current methodology for calculating over-run charges on constrained days is too lenient, and considers a more punitive regime to be necessary.

NE suggests that the weighted average of the highest 25% bid and offers is used in the overrun charge calculation rather than the highest bid and highest offer.

Removal of Gate Closure

Four shippers (TXU,V,BGT,SGD) express concern with the proposal to remove the day ahead gate closure

due to the uncertainty to shippers this can introduce in the level of overrun charges hence leading to a situation where potentially high overrun costs are factored into OCM bids.

SGD expresses concerns with the removal of the gate closure which can allow high overrun charges to be set late in the day by specific shipper bids, thus introducing a gaming opportunity.

AGL expresses support for the removal of the gate closure to allow bids and offers accepted within day to determine the level of overrun charges.

Definition of "Constrained Days"

Five shippers (V,BGT,SGD,SSE,Co) express concerns with the proposed definition of "constrained day". Three shippers (V,SGD,BGT) suggest that the definition should go further to take account of days where, following full interruption of interruptible capacity, an amount of interruptible capacity is reinstated later in the day.

BGT argues that a day should not be declared constrained where Transco has bought back capacity for commercial reasons.

Co argues that the definition should be extended to include those occasions where Transco has bought back, Scaled back, or curtailed firm or interruptible capacity.

SSE enquires how the proposed definition takes into account Transco's ability to alleviate a constraint by buying back capacity at a 'linked' terminal.

AGL and BG express support for the definition put forward in the modification proposal.

Other Comments

SSE suggests that the proposed changes to the overrun charge methodology should be conditional on the implementation of a manifest error procedure to unwind erroneous capacity bids and to guard against unnecessary extreme prices setting overrun charges.

SSE also suggests a means of displaying the prevailing overrun charge at each entry point to shippers on a real-time basis.

NE draws attention to a possible situation where Transco inappropriately allocates the available capacity, a shipper has capacity bids rejected despite the system not being constrained, and the shipper subsequently incurs high overrun charges. NE suggests it would be appropriate to alter the overrun charge calculation such that the highest bid and offer should be replaced with the highest 25% of the weighted average bid and offer.

Transco's Response

General

Transco welcomes the support expressed by the majority of respondents for the proposal. Transco agrees that the overrun charges should be set at such a level to support the "ticket to ride" principle but still encourage shippers to bring additional gas to the market. It recognises that any further reduction in the level of overrun charges could undermine the principle of booking capacity in the first instance.

Transco acknowledges the comment expressed that the introduction of the within day capacity market may have reduced the likelihood of shippers overrunning, but it believes that an overrun regime that appears to generate charges that might be considered to be non cost-reflective may undermine the objective of maximising availability of capacity which the daily market is designed to facilitate. Transco believes that an appropriate level of overrun charges should also reflect the consequences on the system arising from shippers delivering in excess of their capacity entitlements.

In respect of the comment raised that interruptible capacity, if used effectively, could negate the need for overrun charges, Transco would argue that the provision of interruptible capacity and the subsequent scaling back does not necessarily guarantee that shippers will alter their gas deliveries to match their revised capacity entitlements. Consequently, the use of overrun charges are to discourage shippers from flowing gas in excess of their capacity entitlements.

Level and Component of Overrun Charge

Transco welcomes the support expressed for the removal of the energy component from the overrun charge calculation for "non-constrained" days. Transco originally proposed the removal of the energy component on the basis that for the majority of days, the level of charge appears higher than might otherwise be considered necessary to ensure the "ticket to ride" principle of the system. Transco has argued that an overrun mechanism based on the costs of any daily capacity buys and sells will more closely reflect the costs of any impact on the system.

Transco has noted that several respondents have indicated that they believe the definition of a "constrained day" is problematic and that the energy component of the overrun might be removed. Transco believes that the capacity related components of the overrun should reflect the value of capacity on the day and it argues that when the system is under stress ("constrained days") such prices might be expected to rise. The application of such prices and the appropriate multiplier should ensure the appropriate discipline.

Having considered the comments raised by shippers in respect of the situations where daily capacity prices could set the overrun charge level, Transco recognises that it may be possible for shippers to manipulate the overrun charge level or set the charge at extreme levels particularly via the process of shipper bid acceptance. In order to minimise the likelihood of such practice and to dampen the effects of extreme prices, Transco proposes that an average of the top 25% bids accepted, pursuant to the buying or selling of daily capacity, weighted by volume, multiplied by 1.1, will be one of the factors within the overrun charge calculation.

However, this will require systems changes beyond those currently envisaged and hence this particular feature could only be introduced from 1 December 2000.

Removal of Gate Closure

Transco acknowledges that the use of the gate closure has provided shippers a degree of certainty in respect of the level of overrun charges they are likely to face during a gas day. However, if this mechanism is allowed to continue it will prevent the use of market prices from potentially setting the level of overrun charges, which Transco believes would prevent one of the intentions of the proposed revision to the overrun regime being achieved. Transco's proposal to both remove the gate closure and to apply the highest 25% of prices for accepted bid and offers in the overrun charge alculation would still allow a degree of transparency in the setting of the overrun charge during the gas day. Shippers will already have knowledge of the

Applicable Daily Rate, and as shippers have access to the prices and quantities for all accepted bids and offers within day, shippers will be able to assess the level of overrun charges on a real time basis.

Definition of "Constrained Days"

Transco acknowledges the comments and concerns raised by respondents in respect of an appropriate and robust definition of a "constrained day" for an ASEP, in particular, in agreeing upon a definition that takes account of buy-backs for commercial reasons versus 'real' constraint reasons and situations where interruptible is reinstated later in the day. However, Transco's revised proposal removes any distinction between whether or not a terminal is declared "constrained" and thus removes the need for such a definition.

Other Comments

Transco recognises the merit in introducing a manifest error procedure to unwind erroneous capacity bids being placed by either Transco or shippers. This has been the subject of recent discussions within the Capacity Workstream meetings. Transco is currently considering the merits and issues associated with such a scheme. Transco believes this should be considered as a priority within the Capacity Workstream.

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 facilitate compliance with safety or other legislation.

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

Implementation is not required as a consequence of any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the License.

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

Parameter Changes to existing billing systems

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

Subject to satisfactory completion and testing of systems, the recommended implementation timetable, if the Modification Proposal is implemented, is as follows :

27 November 2000, amendment to billing systems goes live for October billing period.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this Modification Proposal is implemented

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 Director General in accordance with this report.

19. Text

See Attachment

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Director General of Gas Supply Response:

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0408**, version **2.0** dated **21/07/2000**) be made as a modification to the Network Code.

Signed for and on Behalf of the Director General of Gas Supply.

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 Director General of Gas Supply ("the Director") 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 Director 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 Director does not so approve the Agreement then Clause 3 shall apply.

2. If the Director 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 Director 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 Director 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 Director 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.

