

24th August 2000

Dear Colleague

RGTA Workstream Discussions: Mod 0420: Change to System Prices & Mod 0421: Temporary Extension of Absolute Tolerance Quantity

Yesterday the RGTA meeting at Tottenham Court Road discussed the above modification proposals. The meeting asked that I write out to the RGTA circulation list to inform them of the discussions that took place so that potential respondents to the consultation on the above two proposals could include comments on the ideas that were raised in the workstream.

Mod 0420: Change to System Prices

In respect of Modification Proposal 0420: Changes to System Prices Transco indicated that the Proposal as drafted did create a potential anomaly. There might be circumstances when the higher of the highest "Market Offer Price" in relation to a "market balancing action" taken for the day or the average of the seven previous days SMP buys is lower than SAP. Such a situation would create perverse shipper balancing incentives.

The workstream therefore agreed that the proposal would be interpreted so that the System Marginal Buy Price should be based upon the highest of the highest "Market Offer Price" in relation to a "market balancing action" taken for the day or the average of the seven previous days SMP buy or SAP. The System Marginal Sell Price would also be determined by the analogous calculation based on "lesser of" rules. The proposer confirmed this was the intent of the proposal.

The workstream then went on to consider three alternative approaches to help ensure there are more frequent differentials between SMPs and SAP.

1. Volatility based approach

A measure of volatility of the SMP buy / SAP differential over a recent period could be calculated. For example, this might be defined as an estimate of the standard deviation of that differential over a fixed period.

If such a measure is referred to as SD then the SMP Buy price could be set to be equal to $SAP + (\text{factor}) * SD$. Alternatively it could be set as the greater of either $SAP + (\text{factor}) * SD$ or the highest "Market Offer Price" in relation to a "market balancing action" taken for that day. A similar approach could then be adopted in respect of the SMP sell derivation.

The key parameters of this approach would be:

- the measure used for the volatility

- the number of previous days to which the measure should apply
- the factor to be applied to the volatility measure to ensure the minimum differential
- whether greater of/lesser of rules should apply involving "market balancing action" prices.

2. System Weighted Average Marginal Price (SWAMP)

Trades in the market could be ranked in price order and then a volume weighted average price for the most expensive 10% of gas could be calculated.

The SMP Buy price could then be set to this derived value or alternatively it might be set to the higher of this price and the highest "Market Offer Price" in relation to a "market balancing action" taken for the day.

An analogous approach could be used to set SMP Sell price.

The key parameters of this approach would be

- the volume percentage to be used in the weighted average calculation
- whether these derived prices should be the sole determinant of the SMPs or whether the greater of/lesser of rules involving "market balancing actions" should apply.

3. Fixed differentials

Fixed differentials could be used in the setting of cashout prices. These could be defined in either absolute or percentage terms. Similarly to the above these could be used as the sole determinants of the SMPs or they could be used in conjunction with greater of/lesser of rules thereby taking account of "market balancing actions"

For example an absolute differential approach might set the SMP Buy at the greater of $SAP + 0.2$ p/kWh or the highest "Market Offer Price" in relation to a "market balancing action".

Alternatively the SMP Buy might be set at the greater of 120% of SAP or the highest "Market Offer Price" in relation to a "market balancing action".

The key parameters of this approach would be

- whether an absolute or percentage based differential approach should be applied
- the magnitude of such parameters
- whether greater/of lesser of rules apply to incorporate "market balancing actions".

Respondents may wish to respond in respect of both the principles associated with the above ideas and the parameters in their responses to Modification Proposal 0420: Changes to System Prices.

Mod 0421: Temporary Extension of Absolute Tolerance Quantity

Several shippers indicated some concern that the Network Code now envisages tighter shipper tolerances following the implementation of Modification 0415: Reduction in Shipper Tolerances. Some shippers suggested that this, when coupled with the planned removal of the ATQ regime may unduly increase shipper risks, particularly for smaller shippers.

At the workstream it was suggested that smaller shippers might need some continued protection from SMP cashout risks that might arise from genuine operational uncertainty. It was acknowledged that the current ATQ regime (which features a complicated Cumulative Imbalance Tolerance Quantity mechanism) might be better replaced by simpler approach. Such an approach could ensure that such imbalances within the ATQ are cashed out on the day rather than being rolled over into the Cumulative Imbalance Quantity cashout regime where such imbalance might be cashed out on a different day, albeit at the SAP for that day.

The workstream requested that the RGTA circulation list is advised of that suggestion to facilitate responses as part of the consultation process associated with Modification Proposal 0421. Responses are due on or before 31st August.

Any responses to the above two Modification Proposals must be received by 31st August. The workstream asked that Transco complete the modification reports for these proposals as soon as possible thereafter. If shippers can forward responses to these consultations ahead of the above deadline it would assist Transco efforts to deliver final modification reports ahead of the 7th September date associated with the timetable for these Modification Proposals.

If you would like to discuss any of the issues raised in this letter please do not hesitate to contact either Eric Fowler (0121 623 2655) or me (0121 623 2458) .

Yours sincerely

Nigel Sisman