

MODIFICATION PROPOSAL No 0411.

Title: postponement of tolerance auctions.

Date: 30 June 2000.

Proposed implementation date: as soon possible, but before 30 September at the latest.

Urgency: Urgent.

Consequence of not making this change:

If this Modification is not implemented shippers will participate in auctions for balancing tolerances in August 2000 for a service commencing in October 2000, without there having been further consideration of the implication of the new service, the new auction process or the revenue recycling. In light of recent experience, both of the last capacity auctions and the operation of the market generally, further refining of this service needs to be considered prior to its implementation. Introduction of the service for October 2000 risks creating additional market distortions, possibly adding the price of delivered gas. The new tolerance service may also make it more difficult for Ofgem or Transco to monitor shippers behaviour on the NTS at a time when Transco has expressed concerns over system security. The service seems likely to add to the gas flow profiles that have concerned Transco in recent weeks and we believe may also unduly discriminate against smaller shippers.

Area Of Network Code Concerned:

The changes from modification 373 would not be implemented until April 2001.

Nature of Proposal:

This proposal seeks to ensure that a tolerance service is not introduced until the gas community and Ofgem have had further time to consider and possibly refine the rule changes introducing the new tolerance service, under modification 373 in October 2000. There is a need to better understand how the changes will work and whether, if introduced now, the service is still likely to be consistent with Transco's relevant objectives. A six month delay gives the community greater opportunity to review the tolerance service in light of recent developments in the gas market, ensuring that the changes are going to meet the relevant objectives, and the service does not unduly discriminate against the interests of smaller shippers.

Purpose of Proposal

During the course of RGTA developments a number of shippers have become concerned that some of the key features that mod 373 was expected to deliver, and that were thought likely to help Transco meet its relevant objectives, are now doubtful. For example it was expected that secondary trading of the balancing service would improve efficiency, but following the capacity experience it seems unlikely that companies will wish to trade the service and the modification may therefore not meet the relevant objectives. As an industry we have also identified problems with the incentives on shippers to balance caused by the current cashout regime. The introduction of the tolerance service at this time may exacerbate the

incentives not to balance, but at the time of agreeing 373 these problems had not been recognised.

Experience with revenue recycling has also raised concerns. The industry have yet to create a mechanism to facilitate the operation of auctions under a revenue price control that does not increase price volatility or add to delivered prices. Modification 373 agreed over recovered revenue from the tolerance auctions would go into "k", but further discussion have raised concerns about the impact of this recycling mechanism on the bidding behaviour of some players and the overall redistributive effects.

Transco also seems more likely to understand and alter signals to influence the gas flow profiles it is concerned about if the implementation of modification 373 is delayed, allowing Transco to ensure the economic and efficient operation of the pipelines. It is now clear that further changes to the on-the-day regime are needed to reassure Transco while facilitating commercial freedom, but these may be more difficult to design on top of the tolerance service. A delay on tolerance services will permit changes to the network code that provide sharper signals to suppliers about balancing, but in a transparent framework. Additional levels of complexity increase possible gaming opportunities for some players, which can reduce the level of effective competition. If traders do not want to trade capacity they are even less likely to want to trade balancing tolerances, so we may see tolerance hoarding which we are not sure Transco can address or Ofgem regulate.

All these problems have come to light since modification 373 was agreed and may be resolved prior to April 2001, but at the moment the introduction of the tolerance service no longer appears to fulfil the relevant objectives. Transco's relevant objectives are thus best fulfilled by at least delaying the introduction of the tolerance service for at least six months.

Identity of Proposer: Lisa Waters

Signature:

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