

CODE MODIFICATION PROPOSAL No xxxx
Revision to Entry Over-run Charges – Weighted highest prices paid
Version x.x

Date: 16/08/2007

Proposed Implementation Date: 01/12/2007

Urgency: Non Urgent

1 The Modification Proposal

a) Nature and Purpose of this Proposal

It is proposed to amend the Entry Overrun Charge by replacing the “8 x highest bid price in relation to a capacity bid in respect of which NTS entry capacity was allocated following an entry capacity auction”, with “8 x the weighted average price of the top 5% by volume in relation to prices paid for capacity effective for that gas day in respect of which NTS entry capacity was allocated following an entry capacity auction.

It is now widely accepted that the National Transmission system faces contractual entry congestion at a number of entry points which are capable of higher inputs to the system, in the sense of there being more demand for entry capacity for Users to enter gas into the System than National Grid have released.

Irrespective of whatever may be considered to be the causes of the unavailability of entry capacity, there appears to be a wide consensus that the industry should urgently investigate steps which might be taken to maximise entry capacity release.

To ensure efficient and fully effective use of the System, the industry should be pursuing possible changes for the coming winter in at least the following areas –

- Trades and transfers of sold and unsold entry capacity between entry points;
- Release of day ahead and within day interruptible capacity;
- To assess the timing and release of such capacity there should be information made available to help all users assess interruptible capacity;
- Use-it-or lose-it arrangements must apply to interruptible capacity too; and
- particularly given the importance of maximising the use of interruptible entry capacity, and the risks associated with committing to use of rights, and also the need to ensure that capacity is fully used rather than used with margins for uncertainty, over-run charges need to not be unduly extreme, proportionate and cost reflective and not penal.

This Modification Proposal addresses just the final area mentioned above,

the area of entry capacity over-run charges.

The Current Position

The current position in respect of Entry Over-run Charges appears in Section B2.12 of the Uniform Network Code.

In summary (Paragraph B2.12.3), the System Entry Overrun Charge is the Overrun Quantity multiplied by whichever is the greatest of –

- i) $8 \times A$, where A is the highest bid price in relation to a capacity bid in respect of which NTS entry capacity was allocated following an entry capacity auction
- ii) $1.1 \times B$, where B is the Relevant Average Accepted Offer Price, which relates to capacity “surrendered” by the User (defined in B2.12.4)
- iii) $1.1 \times C$, where C is the Relevant Average Accepted Forward Price, which again relates to capacity “surrendered” by the User, but here surrendered “before the Day” (defined in B2.12.5)
- iv) $1.1 \times D$, where D is the Relevant Average Accepted Exercise Price, relating to capacity “surrendered” by the User under an option arrangement (defined in B2.12.6)

The Proposal and Justification

The rules in (ii), (iii) and (iv) above relate to NG buying back capacity (and thereby cost reflective as they reflect actual costs of capacity management) and are not considered to be in need of revision. However that in (i), if not changed, will have an impact which is simply an order of magnitude different from that envisaged when the rule was first appeared in Transco’s Network Code and given further regime change now has the potential to distort competition between shippers.

The “8 times” multiplier was introduced in 1998 in Network Code Modification 244a. At the time the buy back clauses did not exist.

There had previously been a “ratchet” mechanism, whereby an entry over-run triggered both an over-run charge and also an increase in the User’s capacity entitlement for a period of 12 months. Transco described that charge as comprising a “level of 182 times the daily charge plus a ratcheted new booking” (Modification FMR).

Shippers raised a Modification to remove the ratchet mechanism and replace it by a “simple” System Entry Overrun Charge calculated daily as the Chargeable Overrun Quantity multiplied by the Applicable Daily Rate of the System Entry Charge multiplied by 8.

There was widespread agreement on removal of the ratchet and the introduction of the simpler structure, but various alternative multipliers were suggested during the ensuing consultation, ranging broadly from 2.3 to 17.

(Although the FMR suggests that Transco's Modification 244a proposed 90, the only copy available of this Modification Proposal instead shows "[N]", ie a number to be determined.)

Transco were concerned that a low multiplier would "greatly reduce the incentive for shippers to make annual capacity bookings and hence reduce the revenue associated with these bookings" and cause "a greater instability in Transco revenue flow" (FMR, sections 6 and 7). Transco mentioned no operational advantages or disadvantages associated with a "high" or "low" multiplier.

Following the apparent shift to a User Commitment model, and subsequent capacity constraints, the User Commitment model for entry capacity is now well enshrined within the business model of producers/interconnector and storage operators. In addition National Grids revenue flow is very certain given the nature of recent Price Controls.

It should be noted that all these events and changes preceded the introduction of entry capacity auctions. At that time the typical cost of entry capacity was less than 1 p/thm, and the "8 times" multiplier was generally likely to generate costs of 1-5 p/thm.

Recent auction prices would generate overrun prices in excess of £1.00 p/th. Not only is this wholly out of line with the expectations back in 1998 when the "8 times" multiplier was introduced, but such Overrun charges will unnecessarily frustrate use of and sterilise economic and efficient use of entry capacity whilst exacerbating the change for competition between shippers to be distorted.

We consider that NG's operational practices in winter 2006 were not necessarily consistent with maximising the entry capacity at congested entry points. Nor is there evidence that NG have to date consulted on or proposed changes which would maximise such capacity. For the avoidance of doubt we maintain that a User should not be unduly penalised if capacity is physically available but not released by NGT as interruptible.

So the key to this proposal is to allow for a more cost reflective use of Entry Capacity Overrun within-day when opportunities exist to flow gas into the points using capacity which has not been offered on either a firm or interruptible basis and also on occasions when capacity sold is not fully used despite any use-it-or-lose-it practices.

Therefore, to avoid risk of sterilisation of unbooked capacity or hoarding of capacity it is in the industry's interests to have a less penal more cost reflective Entry Overrun Charge than is likely to apply if the highest bid price multiplied by '8' remains, and this would otherwise unnecessarily act as a deterrent to efficient and effective use of the System.

As regards a more helpful level, it is recommended that the multiplier be applied to the weighted average price of the top 5% by volume in relation to prices paid for capacity effective for that gas day in respect of which NTS

entry capacity was allocated following an entry capacity auction

It is considered that without the change the actual use of entry over-runs will be negligible. With the proposed change, the use may remain small, if suitable and sufficient other changes are introduced.

The proposer intends to introduce the concept of the weighted average price of the top 5% by volume for capacity at that entry point for that gas day to remove the opportunity for an ineffectually small purchase of capacity setting a disproportionately high Entry Overrun price with the significant opportunity to distort competition between competing shippers.

b) Justification for Urgency and recommendation on the procedure and timetable to be followed (if applicable)

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c) Recommendation on whether this Proposal should proceed to the review procedures, the Development Phase, the Consultation Phase or be referred to a Workstream for discussion.

The proposer recommends this draft proposal be discussed at workstream.

On the basis that the proposed change can reduce the likelihood of gas being stranded offshore due to insufficient Entry Capacity being made contractually available, the proposer believes 1st December 2007 is a suitable implementation date.

2 Extent to which implementation of this Modification Proposal would better facilitate the achievement (for the purposes of each Transporter's Licence) of the Relevant Objectives

The Proposer believes this modification alleviates the clear inefficiency of not ensuring the release (by one means or another) of all capacity that is physically available and the resulting risk of or likelihood of sterilisation of capacity and thereby better facilitating the Relevant Objectives.

3 The implications of implementing this Modification Proposal on security of supply, operation of the Total System and industry fragmentation

The Proposer believes that this Proposal, if implemented, will enhance security of supply by allowing Users the opportunity to use more Capacity at all ASEPs than would otherwise be the case.

4 The implications for Transporters and each Transporter of implementing this Modification Proposal, including:

a) The implications for operation of the System:

The Proposer does not believe this Proposal, if implemented, would in itself affect the physical operation of the System.

b) The development and capital cost and operating cost implications:

The Proposer does not foresee material development, capital or operating cost impacts, as mentioned earlier.

c) Whether it is appropriate to recover all or any of the costs and, if so, a proposal for the most appropriate way for these costs to be recovered:

Not applicable.

d) The consequence (if any) on the level of contractual risk of each Transporter under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

The Proposer believes that the Proposal will encourage National Grid to release all available firm and interruptible capacity so as to minimise the volume and frequency of use of entry capacity overrun by shippers and subsequent capacity actions by NG.

We see no impact on Distribution Network transporters.

5 The extent to which the implementation is required to enable each Transporter to facilitate compliance with a safety notice from the Health and Safety Executive pursuant to Standard Condition A11 (14) (Transporters Only)

Not applicable.

6 The development implications and other implications for the UK Link System of the Transporter, related computer systems of each Transporter and related computer systems of Users

The calculation of entry capacity will need to be changed.

7 The implications for Users of implementing the Modification Proposal, including:

a) The administrative and operational implications (including impact upon manual processes and procedures)

Negligible.

b) The development and capital cost and operating cost implications

Nil.

- c) **The consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal**

Nil.

- 8 The implications of the implementation for other relevant persons (including, but without limitation, Users, Connected System Operators, Consumers, Terminal Operators, Storage Operators, Suppliers and producers and, to the extent not so otherwise addressed, any Non-Code Party)**

Nil.

- 9 Consequences on the legislative and regulatory obligations and contractual relationships of the Transporters**

Nil.

- 10 Analysis of any advantages or disadvantages of implementation of the Modification Proposal not otherwise identified in paragraphs 2 to 9 above**

Advantages

The proposed Code change is simple and should not disadvantage anyone.

Disadvantages

None identified.

- 11 Summary of representations received as a result of consultation by the Proposer (to the extent that the import of those representations are not reflected elsewhere in this Proposal)**

- 12 Detail of all other representations received and considered by the Proposer**

- 13 Any other matter the Proposer considers needs to be addressed**

- 14 Recommendations on the time scale for the implementation of the whole or any part of this Modification Proposal**

- 15 Comments on Suggested Text**

16 Suggested Text

Code Concerned, sections and paragraphs

Uniform Network Code

Transportation Principal Document

Section(s)

Proposer's Representative

Roddy Monroe - Centrica Storage Ltd

Proposer

James Lawson - Centrica Storage Ltd