

ANNEX TO MODIFICATION PROPOSAL 0014
MARGINS AND TOP-UP ANOMALIES.

Margins anomaly

Under the code, TransCo is made neutral to gains and losses arising out of the balancing regime by paying or recovering "Balancing Neutrality Charges". Balancing Neutrality Charges are derived from a "Basic Net Neutrality Amount" and an "Adjustment Neutrality Amount" for each day (*Section F4.4*).

The Basic Neutrality Amount reflects the net amount of payments and receipts for flexibility bids, imbalance charges and scheduling charges. The Adjustment Neutrality Amount reflects a number of adjustments including recoverable costs of operating margins and balancing margins, charges or credits for unauthorised gas flows, unpaid or late paid energy balancing charges, financing charges and various miscellaneous amounts (including the top-up amounts referred to below). The division between basic and adjustment amounts reflects what is systematised and what is entered manually onto AT-LINK.

In each month of phase 1 of the soft landing, if certain net amounts which are recoverable by TransCo from shippers as Balancing Neutrality Charges exceed a specified cap (£10 million in March 1996 rising to a cumulative £36 million in August 1996), TransCo is to cease using the flexibility market for the remainder of the month in question. Instead, TransCo will only use the flexibility bids posted by British Gas Trading, which are taken to have a bid price of the 30-day system average price.

In order to simplify the monitoring required to implement this rule, the cap each month under the Code is applied to Balancing Neutrality Charges calculated only on the basis of the Basic Net Neutrality Amount (*paragraph 4.2.5, Part II, Transition Document*). This approach has however had an unforeseen result, in that amounts notionally payable to TransCo for operating margins and balancing margins use count towards utilisation of the cap, whereas the amounts which are rebated to shippers in respect of the same use of margins do not. This arises as follows.

When TransCo uses operating or balancing margins, the relevant margins account is out of balance, having a positive imbalance, ie. TransCo has delivered gas to the system without any corresponding deemed offtake. Energy balancing therefore pays the margins account an imbalance charge. The imbalance charge counts towards the Basic Net Neutrality Amount; it counts towards the phase 1 monthly cap.

This is offset by the inclusion in Balancing Neutrality Charges of the "Daily Margins Recovery Amount". This amount is a deemed receipt by energy balancing, intended to ensure that TransCo is reimbursed only for recoverable margins costs. It is the difference between the imbalance charge payable to the margins account, and the recoverable costs of margins (cost of gas and financing costs). The effect is to reduce the amount of Balancing Neutrality Charges payable by Shippers (assuming end of month cash-out SAP exceeds net WACOG for balancing margins). However, the Daily Margins Recovery Amount is part of the Adjustment Neutrality Amount; it therefore does not count (to be netted off) towards the monthly cap.

To summarise, a notional payment is made by energy balancing for use of margins which increases expenditure towards the monthly cap, but the off-setting credit (which will ensure that actual Balancing Neutrality Charges payable by shippers are reduced) does not count to reduce expenditure towards the cap.

In order to remedy this anomaly, it is proposed that the monthly cap mechanism be modified so as to include the Daily Margins Recovery Amount.

Top-up anomaly

There is a similar anomaly in connection with top-up. In the storage year 1995/96, balancing margins gas in Rough is bid onto the flexibility market as top-up. Where such a top-up bid is accepted, the utilisation of the gas is treated as being utilisation for margins purposes. In normal cases there is a separate top-up neutrality mechanism which rebates to shippers the net revenues from the top-up bid (i.e. the bid price, less the Top-up Manager's recoverable costs). However for top-up bids made from balancing margins (in 1995/96), instead of separate top-up neutrality mechanism, the net revenues from the top-up bid are rebated through energy balancing neutrality. This is achieved through inclusion of these amounts as an additional Balancing Neutrality Adjustment Revenue in the calculation of Balancing Neutrality Charges (*see P5 under Section P in paragraph 8 Part II, Transition Document*).

As in the case above, the flexibility payment made to the Top-up manager counts towards the monthly cap, but the offsetting amount (which ensures that the actual balancing neutrality charges payable by shippers is reduced) is not counted.

In order to remedy this anomaly, it is proposed that the monthly cap mechanism be modified so as to include the net revenues from top-up flexibility bids made from balancing margins.

Affects on Calculation of £10 m cap for March.

Indicative figures on the impact on the calculation of the cap:

Basic Net Neutrality	£15.34 m
Rebate Neutrality	£ 3.44 m

Shipper position is therefore:

10 - 3.44 = £6.56 million and,
TransCo £5.34 million.

Therefore with drafting clarification:

Daily Margins Recovery Amount	£11.90 m
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Shipper position is therefore £10 million and TransCo £1.9 million.

Note: The calculations are based on data prior to March allocations close-out.