Modification Report
URGENT Modification Reference Number 244/244a
Reduction of Overrun Charges

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.12.4.

1. Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.2(a) Ofgas has agreed that this Modification Proposal should be treated as Urgent. The justification for this is that if a reduction in the overrun multiplier is appropriate, it should be implemented for the coming winter. Its implementation is also linked with the proposed "use-it-or-lose-it" capacity services which are targeted for implementation in October 1998 to coincide with the start of the new gas year.

2. Procedures Followed:

Transco agreed with Ofgas (and has followed) the following procedures for this Proposal;

22 July	Ofgas agree proposal as urgent
28 August	Close out of Shipper representations
7 September	Modification Report to Ofgas
11 September	Ofgas decision expected

3. The Modification Proposal:

Enron proposed modification 244 and Transco proposed the alternate 244a for a reduction of entry overrun charges.

Modification 244 proposed;

- A daily capacity overrun calculation to replace the current monthly process
- That where the physical capacity exists, (i.e. where gas has flowed), gas delivered in excess of a shipper's Available Aggregate System Entry Capacity shall be deemed to flow pursuant to an Interruptible Entry Service.
- The entry rate for such interruptible service shall be equal to 8 times the daily firm entry rate at that point.

A subsequent paper circulated by Enron suggested that the overrun multiplier might be as low as 2.3 times the daily System Entry rate.

Modification 244a was raised to allow for development of the principles of the proposal but differed in that the proposed multiplier was 90. A subsequent paper circulated by Transco contained analysis that supported an overrun multiplier of 16 times the daily System Entry rate.

There are also associated modification proposals (247/247a) which propose that Flexibility and System Entry overrun charges are aligned. Changes in methodology of overrun calculation have been considered within that report as opposed to here. Proposal 247/247a comprises the following;

a) System Entry overrun quantities will be evaluated and charges will be applied on a daily basis,

b) The ratchet mechanism for automatically booking System Entry capacity will be discontinued,

c) The multiplier applied to System Entry overrun quantities and flexibility overrun quantities will be identical.

4. Transco's opinion:

Transco agree that a high System Entry overrun multiplier may discourage the entry of gas when the flow would be above a shippers available capacity level. A reduction in the multiplier will lower the disincentive for entry of gas above the available capacity but may also lead to a reduction in the level of annual capacity bookings, the so called 'flight from firm'. The level of overrun incentive should preserve some incentive for shippers to make capacity bookings or to use defined services. Transco have concluded an acceptable balance between facilitation of gas entering the system and incentivising capacity booking is achieved with a daily overrun multiplier of 16.

The changes to the method for calculating the System Entry overrun quantity, daily calculation rather than largest in month, creates an alignment of method with the flexibility overrun regime. With a daily calculation of overrun and a significantly lower overrun multiplier there is no longer a need for a ratchet booking mechanism to protect shippers from the effects of several days of successive overruns. The proposals to align the mechanism used for System Entry overruns and Flexibility overruns have been developed in Modification 247a.

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

This modification will facilitate competition between shippers for gas supplies into the System and may reduce one potential cause of artificially high gas prices on days of high demand. This in turn will allow more efficient and economic utilization of the System.

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

a) implications for the operation of the System and any BG Storage Facility:

The implementation of this proposal will facilitate the availability of gas for system entry on days of high demand. A greater availability of gas may reduce gas costs to the System.

BG Storage have proposed a number of changes to storage services including a lower overrun multiplier for storage withdrawal services. This modification will potentially reduce shippers' requirement for storage gas on days when their only other option was to incur a high capacity overrun charge for deliveries above their available 'beach' capacity.

b) development and capital cost and operating cost implications:

The reduction of the System Entry overrun multiplier does not lead to any capital cost implications. Altering the calculation process from the current monthly to a daily overrun will lead to an increase in manual workload for Transco in the short term. In time it is anticipated that a systems solution would be sought.

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:

The calculation of overrun charges is necessary to support the current capacity regime. Any costs associated with making these calculations are considered to be part of the normal shipper services and are therefore included within the pricing formula.

d) analysis of the consequences (if any) this proposal would have on price regulation:

There are consequences if the System Entry overrun multiplier is set too low. A low multiplier would greatly reduce the incentive for shippers to make annual capacity bookings and hence reduce the revenue recovery associated with these bookings. In the absence of any other mechanism for shippers to acquire capacity there is likely to be a great increase in the number of overruns and the revenue flow through overrun charges. These factors would increase the degree to which revenue recovery is dependant on System throughput and may thus contribute to over or under recovery of Transco allowed revenues. This in turn creates pricing volatility for shippers which is both undesirable and is difficult to reconcile with cost reflectivity.

7. **<u>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:</u>**

A reduction in the overrun multiplier will reduce the level of incentive on shippers to make annual System Entry capacity bookings. This may lead to a greater instability in Transco revenue flow and the potential over or under recovery of allowed revenues. Shippers may incur a greater number of overrun charges and there is potential for a greater number of invoice disputes.

8. **<u>The development implications and other implications for computer systems of Transco and related computer systems of Relevant Shippers:</u>**

Overrun quantities are calculated on the AT Link systems and are then managed via manual spreadsheets to derive overrun charges. Development implications are therefore limited to changes in manual processing as opposed to systems implications. The number of overruns is likely to increase.

9. **<u>The implications of implementing the Modification Proposal for Relevant Shippers:</u>**

Shippers will be able to continue to deliver gas into the system above their Available System Entry capacity but a lower overrun charge will act as less of a disincentive for these deliveries. A lower level of System Entry overrun charge may deliver the benefit that more gas is available to the within day gas markets so shippers are better able to manage their portfolio balance.

10. **<u>The implications of implementing the Modification Proposal for terminal operators, suppliers, producers and, any Non-Network Code Party:</u>**

If the System Entry overrun multiplier is lower then shippers will be more willing to take deliveries of gas above their Available System Entry capacity. This will facilitate entry of gas at lower price levels as the premium element associated with overrun gas will be reduced. This will make additional gas supplies more competitive on days when there is a requirement for additional gas and may reduce the likelihood of price 'spikes' on days of high demand.

11. **<u>Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each Relevant Shipper and Non-Network Code Party of implementing the Modification Proposal</u>:**

No consequences

12. Analysis of any advantages or disadvantages of the implementation of the Modification Proposal:

A reduction in the level of overrun charges will facilitate entry of gas to the System, particularly at times of high demand. This in turn may reduce the price of gas. If the level of overrun charge is set too low then there is likely to be a significant reduction in annual capacity bookings and a shift to revenue recovery through the overrun mechanism. This will reduce the stability of revenue recovery and may lead to greater volatility of Transportation prices between years. Transco have shown in the recent paper *"Proposes Changes to the Entry Capacity Regime"* that a daily overrun multiplier of 16 substantially retains revenue stability and booking incentives whilst better facilitating the delivery of gas to the system.

Operationally, an increase in the number of overruns presents some difficulty as the calculation of charges is a manual process.

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

Representations have been received from 17 Shippers and System Users.

Mobil did not support any change as they believe that more consideration needs to be given to the issues before progressing any further with the modifications. Yorkshire Energy expressed the concern that the modification would substantially affect the value of shippers' current capacity holdings. While they support the principle of reducing the level of overrun multiplier they did not support a reduction to a level which undermines the incentive to book capacity or undermines the value of capacity held. They suggest that an alternative might be to relate the overrun charge to a multiple of the System Marginal Price, or Market Average Price.

Within the other representations there was a general support for changing the calculation of the overrun quantity from a monthly to a daily mechanism. There was also general support for the proposal that the ratchet mechanism be discontinued.

There were differences of opinion on the level of multiplier that should be used to calculate overrun charges. United and Shell Gas Direct advocated a multiplier of 4 times the daily rate although no analysis was provided to support this conclusion. Agas, Scottish Hydro Electric, Amoco and Enron support a multiplier of 8 although only Enron provide supporting arguments for this conclusion. Agas acknowledge that the level should ensure that there is not a 'flight from firm' capacity. Scottish Hydro Electric note that the analysis conducted by Transco and Enron has delivered significantly different results but that without performing a similar analysis it is difficult to for them to make their own determination. They indicate that a multiplier of 8 is their preferred level. Scottish Hydro Electric also express the view that if an over-delivery by a shipper causes a constrained position for other shippers, the overrun penalty should be more onerous.

National Power also prefer a multiplier of 8 but would be prepared to accept the Transco proposal of 16. Dynergy suggest that the multiplier could be as low as 2, that they would prefer 8 but would also accept 16. BP Gas believe that the level should be 'no lower than 8'.

BG Storage support a reduction in the overrun multiplier as this encourages the use of the new 'low cost overruns' for Rough and Hornsea services. BG Storage support a multiple of 12 although they do suggest that a consideration should be given to a lower multiplier in summer. BG Storage suggest that the lower overrun multiplier will make more capacity available and that this development would reduce the requirement for daily capacity services.

Southern Electric Gas also support a multiple of 12 at constrained (high daily entry price) terminals although they note that a unconstrained terminals (low daily price) it may be appropriate to have a higher multiple to prevent a flight from firm.

British Gas Trading argue that the analysis presented by Transco and Enron does not reflect shippers' booking behaviour, that shippers will not make their full peak booking at 1 October but will delay booking until the requirement arises, and that the level of multipliers have been understated. BGT suggest that a multiplier of about 16-17 is appropriate.

Eastern Power and Energy Trading support a figure of 16, 'to maintain incentives for booking firm'.

Transco Response:

Transco note the diversity of the representations received. It should be considered that any reduction in overrun multiplier is from the current level of 182 times the daily charge, plus a ratcheted annual booking, to a new lower level. The development of new capacity services should also be considered. The new services will provide shippers with an opportunity to manage the risk presented in the event that gas deliveries are likely to exceed their available capacity holding. Transco believe that a multiplier of 16 provides a very significant reduction in the level of risk faced by shippers and facilitate the provision of extra gas at lower prices.

Transco believe that the multiplier should not be set to less than 16 because a lower level is likely to lead to a significant 'flight from firm' and will also inhibit the development of new capacity services. Transco do not believe that the lack of a seasonal adjustment to the multiplier presents a serious difficulty to users of storage services.

Transco believe that the level of the multiplier should be reviewed in the light of experience following implementation of this modification.

14. **The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation:**

Not applicable

15. **The extent to which the implementation is required having regard to 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 Licence:**

Not applicable

16. **Programme of works required as a consequence of implementing the Modification Proposal:**

The changes required for implementation of this modification will result in alterations to Transco internal procedures for calculating overrun charges. A programme of works is not required.

17. **Proposed implementation timetable (inc timetable for any necessary information systems changes):**

It is proposed to implement the changes with effect from 1 October 1998

18. **Recommendation concerning implementation of the Modification Proposal:**

Transco recommends that this proposal, should be implemented and seeks a direction accordingly

19. **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.

20. **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.

21. Text provided pursuant to Rule 9:

No legal text is provided at this time as Transco believe it is appropriate to establish the outcome of modification 247/247a before clear and concise Code text can be finalized.

Signed for and on behalf of Transco.

Signature:

John Lockett
Manager, Network Code

Date: [needs a 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 244, version 1.0 dated 07/09/98) be made as a modification to the Network Code.

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

Signature: Rebecca Purves

~~Director of Transportation Regulation~~ Head of Gas Balancing [needs a new name]

Date: 25 September 1998

The Network Code is hereby modified, with effect from , in accordance with the proposal as set out in this Modification Report, version 1.0.

Signature:

Process Manager - Network Code
Transco

Date:

ANNEX

Restrictive Trade Practices Act - Suspense Clause

For the purposes of the Restrictive Trade Practices Act 1976, this document forms part of the Agreement relating to the Network Code which has been exempted from the Act pursuant to the provisions of the Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996. Additional information inserted into the document since the previous version constitutes a variation of the Agreement and as such, this document must contain the following suspense clause.

1. Suspense Clause:

1.1 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 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 paragraph 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996.

provided that if the Director does not so approve the Agreement then Clause 1.2 shall apply.

1.2 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect until the day following the date on which particulars of this Agreement and of any such arrangement have been furnished to the Office of Fair Trading under Section 24 of the Act (or on such later date as may be provided for in relation to any such provision) and the parties hereto agree to furnish such particulars within three months of the date of this Agreement.