

**TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0420**  
**"Change to System Prices"**  
**Version 1.0**

**Date:** 14 August 2000

**Implementation Date:** as soon as possible

**Urgency:** Urgent

**Justification:**

**Consequences of not making this change:**

If this Modification is not implemented incentives to balance will remain weak and it is likely that some shippers will continue to try and influence Transco's balancing actions to their own commercial advantage. The artificial marginal system prices, set equal to SAP when no actions are taken, will continue to influence shipper behaviour. These artificial prices not only send some perverse incentives to remain out of balance, but also do not reflect the true cost of gas and may in the long term risk system security.

**Area of Network Code concerned:**

Section F: 1.2 System Prices (1.2.1).

**Nature of Proposal:**

This proposal seeks to ensure that on all gas days there is a difference between SMPs and the SAP in order to encourage shipper balancing and to better reflect the costs associated with imbalances. Ending the artificial SMPs (both buys and sells) should allow Transco to better fulfil their relevant objectives by improving the efficiency of the system and insuring system prices are a reasonable representation of the economic situation on the system.

The code should charge shippers SAP for all energy imbalances within the shipper's tolerance. However, where the shipper is outside his tolerance he should be charged a different amount, as the average cost of his imbalance is unlikely to be equal to SAP and his balancing does impact on the efficiency of the network of which he is only one user.

The "System Marginal Buy Price" should therefore be equal to the **higher of** the highest "Market Offer Price" in relation to a "market balancing action" taken for that day, or the average of the seven previous days SMP buys.

The "System Marginal Sell Price" should be the **lower of** the Market Offer Price in relation to a "market balancing action" taken for that day, or the average of the seven previous days SMP sell.

On days when Transco takes no market balancing actions then the SAP is also the average of the previous seven days SAP (as is the case under 1.2.2), but the rules on SMPs, outline above, also stand.

### **Purpose of Proposal:**

During the course of RGTA developments, and in light of recent gas flows, a number of parties, including Ofgem, have raised concerns about the impact of cash-out prices on balancing incentives. The main concerns seem to stem from the fact that SAP can to often equal SMP removing the incentive on shippers to balance. In fact at times the prices seem to send a signal that encourages shippers to increase their imbalance in order to get paid favourable imbalance prices for gas. The effect of the existing system price structure also appears to be worsening the imbalance positions of shippers across the system as a whole, causing concern over system security, these are problems that need to be addressed urgently.

By ensuring there is always a price differential shippers will see a stronger incentive to balance. This should help Transco to run the system in an efficient and economic way, with lower balancing costs to the system as each shipper will want to match its own inputs and off-takes. The days of significant benefits being accrued to shippers from imbalance prices will end. In turn gas flows may become more stable and predictable, which again should improve efficiency and should also allow Transco to free up more entry capacity within day to the benefit of customers.

An alternative cashout regime should also help better facilitate effective competition. At the moment it is only larger shippers with relatively flexible gas production facilities that appear likely to benefit from forcing balancing action and then ensuring cashout of their imbalance at a favourable price. These shippers have an unfair advantage at the expense of smaller players, or those with gas flows from offshore that they cannot control. Players competing on a level playing field should be good for customers as it will result in effective competition and thus lower prices.

Finally the proposal should improve system security, thus ensuring gas flows to customers. While changing cashout does not get round the fact that balancing is to end of day and shippers with flexible portfolios therefore have time to fluctuate gas flows, the reward for doing so should be less. Shippers will therefore be more likely to flow gas on a flatter profile to the benefit of system security. This is important during the winter when higher demand is more likely to mean that customers would be effected by any system failure.

We believe this proposal better facilitates the relevant objectives and should be adopted as soon as possible to try and improve the balancing incentives within the UK gas market.

### **Proposer's Representative**

Lisa Waters

Position: Regulatory Analyst  
Company: V-is-on gas

**Proposer**

Lisa Waters (V-is-on gas)

**Signature:**

.....