Modification Report
Change to System Cash Out Prices
Modification Reference Number 0433

Version 6.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

This proposal is to introduce a guaranteed minimum differential into the mechanism applied for the determination of system cash-out prices. The introduction of a minimum differential would enhance the incentive for shippers to achieve an energy balance and thus improve the balance of the System. In addition an enhanced incentive may encourage greater trading of gas between shippers and thus benefit liquidity in traded markets.

Proposed changes to the mechanism for determination of prices to be used for energy balancing cash-out:

The SMPbuy price for a gas day will be set as the greater of; the SAP plus 0.0287p/kWh (0.84p/th) or the price in pence/kWh of the highest priced Transco market action (excluding those actions specifically exempt).

The SMPsell price for a gas day will be set as the lower of; the SAP minus 0.0324p/kWh (0.95p/th) or the price in pence/kWh of the lowest priced Transco market action (excluding those actions specifically exempt).

It is recognised that there is an interaction between this Modification Proposal and Modification Proposal 0414 "Energy Balancing Incentive Re-design". The current performance measure for Transco's energy incentive is based upon SMP-SAP differentials. If the cash-out price definition process is amended then Transco believes that it is also appropriate to amend the Network Code in respect of the prices used to determine the Transco incentive to ensure that the intended incentive effect continues. This proposal would ensure that the incentive remains based on the difference between the SAP and the prices set as a result of Transco market actions.

2. Transco's Opinion

The Network Code energy balancing regime was designed to provide commercial incentives for shippers to balance inputs and off-takes on the Transco system by applying system cash-out prices to shipper imbalances measured at the end of each gas day. The prices to be applied to any imbalance volumes were intended to be reflective of the value of flexibility used to ensure an appropriate System balance. The application of the derived prices was intended to achieve a degree of cost targeting to those shippers out of balance. Imbalances within a tolerance are cashed-out at a System Average Price (SAP),

representing a 'neutral' price for 'modest' imbalances. Imbalance volumes falling outside of tolerance are cashed out at the appropriate System Marginal Price (SMP). The use of SMPs should incentivise shippers towards achieving a balance within tolerance. The derivation of these SMPs is dependent on Transco balancing actions and will typically be the highest and lowest prices associated with Transco actions. On days when Transco has taken no balancing actions, or where the highest price of any Transco trade is less than SAP then the SMPbuy Price will be set equal to SAP. Similarly, on days where Transco has taken no action or the lowest price for any Transco trade is greater than SAP then the SMPsell price will be set equal to SAP.

There may be circumstances where the SAP is attractive relative to the price at which shippers value gas and shippers thus have a commercial incentive to adopt a particular imbalance position. Unless Transco takes balancing actions that set unattractive SMPs for such shippers there will be no incentive for them to contain imbalances to within tolerances. The current regime does not always facilitate timely discovery of these imbalances and therefore it is not always possible to correct a System imbalance position through the use of market tools. This may lead to significant linepack imbalances at end-of-day.

Transco has expressed concerns that the efficient operation of the System may be adversely affected by the level of gas imbalance that is being experienced, both within day and at the end of day. Such imbalances have caused concerns regarding the efficient operation of the network and may have led to inappropriately targeted costs. The structure of the current cashout regime has remained largely unchanged despite the implementation of NGTA in October 1999. However, the degree of commercial freedom within the energy-balancing regime has changed and it now appears that the current cash-out arrangements may no longer deliver shipper incentives consistent with efficient balancing of the System. If the cash-out incentive regime remains unchanged and shipper balancing continues to deteriorate then two potential situations arise:

1) Transco may be forced to take a greater number of balancing actions late in the gas day when gas flexibility is more limited and market prices tend to be more extreme. Late and large flow rate changes are problematic and impose additional operational risks on Transco and gas producers/terminal operators. For example, large rate changes may precipitate plant trips that lead to loss of supply.

2) If the imbalance cannot be corrected before the end of the day then the regime may generate considerable mis-allocation of costs between days.

The issue of system cash-out prices was recently considered under Modification Proposal 0420. The proposal was rejected as it contained a flaw that would cause extreme prices to influence cash-out prices indefinitely generating SMPs that have an underlying tendency to

diverge. Ofgem believed these flaws would create impacts in the gas market leading to distortions in competition between shippers and suppliers by setting non-market reflective cash-out prices for shippers out of balance. This modification proposal is based on a simple fixed minimum differential. The values proposed have been chosen taking into account the typical size of SAP to SMP price differentials and a methodology described by Ofgem to unbundle Hornsea storage service prices as a proxy for the value of system flexibility. This methodology was described in outline in the workstream report for this proposal.

Transco supports the implementation of enhancements to the cashout mechanism and believes that it would also be appropriate to amend the legal drafting defining the prices used in determination of the Transco energy incentive. Such amendment would ensure that the intention of the incentive is maintained, i.e. to encourage Transco to take balancing actions at prices as close as possible to the market average.

In the decision letter for Proposal 0420 Ofgem stated that it is convinced that there is a need for reform of the cash-out regime in the short term and that the industry should consider alternative solutions. In view of concerns regarding the operation of the System Transco also seeks to enhance shipper incentives for energy balancing to ensure that the System remains safely and efficiently balanced. Transco believes that this proposal, for a minimum fixed differential between SAP and SMP, provides a simple and pragmatic interim solution until such time as more sophisticated price setting mechanisms are developed.

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

Transco has argued that a regime with enhanced incentives for shippers to balance would lead to more efficient operation of the System. In addition it could be argued that incentives that encourage increased shipper to shipper trading would promote liquidity in gas markets and facilitate competition between shippers. Greater levels of trading might also lead to more efficient price discovery and potentially lower prices for gas that would benefit gas consumers.

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

a) implications for the operation of the System:

Transco believes that enhancement to the incentives for shippers to balance would be beneficial for the operation of the System. Transco has expressed concern regarding the apparent change in shipper balancing behaviour and the consequent uncertainty about the requirement for Transco to undertake balancing actions. Any enhancement to the incentives for shippers to achieve a balance would reduce the Transco requirement and thus might provide for more stable and reliable operation of the network.

b) development and capital cost and operating cost implications:

A revision to the mechanism for the calculation of cashout prices would require some changes to Transco systems. In the short term a manual process could be performed to provide cashout prices according to the agreed after the day publication timetable. The availability of information closer to real-time would be dependent on the complexity of the solution chosen. For example, a simple fixed differential about the SAP would be easy to calculate in real time if the derivation of SAP remained unchanged. Capital and operating costs are anticipated to be minimal.

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:

Costs of system development would be met from allowed revenues for such purposes.

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

No such consequences are anticipated

5. 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

The modification proposal is not intended to adversely affect the existing Transco energy incentive and drafting changes would separate the default prices used for imbalance cashout from the prices considered under the Transco performance measure. If implemented the proposal might lead to Transco taking fewer balancing actions and might therefore influence the out-turn of the Transco energy balancing incentive. A reform of the incentive arrangements is being considered separately under modification proposal 0414.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

A change to the method of calculating System cashout prices might precipitate a need to change functionality within the EnMO system if within-day estimates of SMP prices are still required. In written response EnMO has indicated that it would be unable to provide online indications of SMPs against the then target implementation date of 1 January 2001.

7. The implications of implementing the Modification Proposal for Users

Users would face enhanced incentives in respect of energy balancing as the current regime would be replaced by one where differential prices would always be set for shipper imbalance quantities falling outside the balancing tolerance. It is argued that whilst the existence of differential prices around the SAP may not always deliver incentives for shippers to aim for a neutral balance position, the price differences would provide stronger

incentives for shippers to achieve imbalance positions within balancing tolerances. This might be expected to enhance the prospects of within-day trading.

8. The implications of implementing the Modification Proposal for Terminal Operators,Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

No direct implications have been identified in discussions

9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

No change to contractual relationships is anticipated.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages:

Simple mechanism to set SMP differentials

Reduction in Transco balancing actions

Step towards commodity plus flexibility cashout

Consistent with anticipated longer term solution

Disadvantages:

Simple fixed differential prices not dynamic

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

Fourteen representations were received in response to this Modification Proposal. Five supported the proposal although two of these supported it as an interim measure only. Seven respondents do not support the proposal. Two of the representations make comments without expressing support for the proposal.

The main issues raised in representations are summarised below under the following headings;

Use of enforced price differentials

Market reflectivity

Interaction with balancing tolerances

Interaction with Transco incentive

Implementation date

The following general comments were made;

Alliance believes that any change to the cash out regime is unlikely to facilitate a reduction in balancing costs or a change in shipper behaviour as end of day imbalance positions are not necessarily reflective of any costs created on the system during the day. Alliance is also doubtful whether implementation of the proposal would reduce within-day profiling. Alliance is concerned that if implemented this modification may increase risk and therefore impose greater costs on smaller players without significant levels of within-day flexibility. Scottish and Southern Energy (SSE) also does not believe that the proposed changes to the regime would resolve the problems that have been identified by Transco in the draft modification report.

BP believes that greater incentives on shippers will result in further promoting Transco's role to that of residual gas balancer and may improve inter-shipper trading thereby increasing liquidity in the market. However, Shell Gas Direct (SGD) has concerns that if this proposal were to be implemented then shippers' balancing actions would be driven by prices that would not be economically efficient and the costs to shippers of taking actions could often out-weigh the benefit.

The Health and Safety Executive makes no specific comment on this proposal but states that it would "expect the industry to implement measures that reduce the risks to system security and would support measures that achieve this end."

Use of enforced price differentials

EnMO believes that a three part cash-out regime remains the most effective tool to encourage shipper balancing and endorses the differential approach to determine the SAP/SMP spread rather than the derived approaches.

Northern Electric and Gas Limited (NEAGL) does not believe that the most effective way in which to control end of day balancing actions is to create a difference between SMP and SAP.

Powergen argues that "robust financial incentives for shippers to balance were always seen as a key feature of the first phase of RGTA." Powergen points out that a proposal for a minimum differential cash-out was included in the first draft of RGTA business rules but

that reservations regarding cost targeting and shippers' abilities to balance led to this feature being removed from the proposal. Scottish Power is also of the opinion that creating a differential from SAP would provide a greater financial incentive for shippers to achieve an end-of-day balance position than existing arrangements. Scottish Power goes on to state that it believes that such a differential would lead to greater market liquidity. In achieving the former, it believes that this will benefit Transco in its role as a residual system balancer and hence impact on the efficient running of the system. In achieving the latter it believes that this could stimulate competition and competitive pricing.

Dynegy supports the ideal of creating a SMP buy-sell spread around SAP. However, Dynegy does not support this proposal but believes that a differential based on a percentage difference around SAP is preferable, arguing that this would be more responsive to System stress.

BGT believes that the main aim of any reform of the gas balancing regime should be enhancement of incentives for shippers to balance.

BGT points out that a feature of a regime that has fixed differential is that as the value of SAP rises so the relative differential decreases. BGT argues that it therefore follows that as the level of SAP increases so fixed differentials provide less of an incentive for shippers to balance. This would appear to be counter-intuitive, that when prices are high indicating a System shortage, the balancing incentives are relatively reduced.

SGD believes that this proposal has been brought forward in response to a view that it may be preferable to have marginal prices more often different from the system average. However, SGD suggests that the solution is to consider what changes might be made to Transco's existing incentives rather than to introduce new arbitrary fixes.

Transco opinion

Transco believes that the absence of a differential between the average and marginal prices to be used in imbalance cash-out may lead to situations where shippers do not face incentives to achieve a balance to within tolerance. The absence of a differential SMP cash-out may lead to poorer shipper balancing performance and this may in turn adversely affect efficient operation of the gas balancing regime. Transco acknowledges that the proposal would not deliver an ideal solution but believes that it would deliver an enhancement when compared with the current arrangements. Transco also believes that enforced cash-out differentials would further encourage within-day trading of gas thereby improving market liquidity. This might facilitate economic efficiency in the regime as shippers would be encouraged to trade in a market rather than relying upon enforced trading with Transco via

the cash-out mechanism. Transco therefore believes that a regime that ensures more robust balancing incentives is desirable.

Market reflectivity

EnMO notes that the use of a storage flexibility price is but one way in which a differential price could be determined.

NEAGL notes that although the proposal attempts to define a market reflective price for flexibility, it considers that "it would still result in inefficient and arbitrary prices that are not reflective of supply and demand fundamentals on the day."

Innogy has previously expressed support for modifications to the regime to introduce differential prices that would encourage trading out of imbalances. However, Innogy believes that the prices should reflect the costs that Transco faces in managing daily imbalances rather than a fixed differential.

Innogy notes that the approach proposed, based on unbundled Hornsea prices, has previously been rejected by the industry and that it sees nothing in the proposal that would reverse that position.

Scottish Power states that is has no wish to see an unduly penal cashout regime in existence, but believes that differentials should exist under present market conditions. Scottish Power would be happy to see the storage flexibility proxy prices which have been calculated used, although it sees these as being dynamic rather than static. Scottish Power believes that calculated SMP differentials should of necessity be lower on average than those delivered as a result of Transco Balancing actions in order to be truly market-reflective.

TXU supports the proposal as a short-term measure to incentivise shippers to balance. However, it does feels that the determination of the fixed price differential may not be a truly reflective flexibility price.

SSE queries the use of default prices in the absence of Transco actions. It argues that if there is no System balancing requirement despite shippers taking imbalance positions then the system is not under stress and SSE questions why arbitrary SMP prices should be set. SSE argues that the OCM could set prices in the absence of Transco actions and that this would be more in keeping with the original NGTA objectives that cash-out prices for shipper imbalances should reflect supply/demand fundamentals.

SSE questions the relevance and reliability of the method used to determine the default SMP cash-out prices and argues that there are concerns that short term storage is not traded in a liquid market and annual storage does not reflect within day flexibility, which may be obtained in other ways.

Powergen believes that the need for strong financial incentives for shippers to balance should be afforded greater priority than the achievement of cost reflectivity. It argues that strong balancing incentives will "induce shipper behavioural changes which will in turn help ensure that overall balancing costs are kept to a minimum."

Powergen recognises that the workstream found it difficult to establish a robust means of setting SMP differential values. However, Powergen is of the view that the proposed default SMP differential values are unlikely to be described as unduly harsh or unduly arbitrary.

BGT does not believe that storage proxy prices offer the best indicator of the value of within day flexibility and would prefer the adoption of a mechanism based on SMP volatility, similar to those discussed during the consideration of Modification 0420. If a storage price based methodology is to be used BGT believes that it should be based on more realistic assumptions regarding the use of storage. BGT concludes that the method described in the workstream report and used to determine the differential values proposed cannot deliver values that are market reflective. The results are dependent on assumptions made in the methodology and are therefore simply reflective of the arbitrary nature of those assumptions.

Aquila points out that it was agreed in the workstream that cash-out prices should reflect supply and demand conditions in the market and that it is therefore important that such prices should be derived on a daily basis. As the prices proposed are fixed they cannot be considered market reflective.

Aquila argues that there many forms of flexibility and that it is not clear whether Hornsea can claim to be price representative of short-term flexibility.

Aquila provides analysis in its representation comparing actual prices set during the gas year 1999/2000 and the proposed differential prices. Aquila identifies that the SAP / SMPbuy differential across the full year (366 days) was 0.75p/th, less than the proposed fixed differential of 0.84p/th. Aquila concludes from the analysis that the "SAP/SMP differentials in 1999/00 were greater than the fixed differentials proposed in 0433 on just 12% of days".

SGD points to earlier comments made by Ofgem accompanying the rejection of modification proposal 0420 that cash-out prices should reflect the pattern of supply and demand throughout the day and the costs of Transco managing any imbalance and that cash-out prices should be market reflective. SGD notes that this proposal will not achieve such objectives.

SGD is not persuaded that the use of Hornsea auctions creates a logical or robust basis for valuing 'flexibility'.

Transco opinion

Transco accepts the view that the use of a fixed value to set a SAP / SMP differential does not fulfil the requirement of being truly market reflective of conditions on the day. However, Transco believes that this requirement should be set against a desire to ensure that consistent incentives apply for shippers to achieve a balance. Transco believes that the proposed values represent a reasonable compromise of the conflicting requirements placed upon the cash-out determination mechanism. Transco believes that the proposed values for the differentials would enhance the incentives for shippers to balance without being unreasonably penal.

Cash-out differentials derived from the Hornsea storage auction prices is considered to provide a simple and transparent mechanism. The analysis provided to the workstream and also that conducted by Aquila shows that the implementation of the proposal would deliver cash-out prices not very dissimilar to those that occurred as a result of actual balancing actions. Transco accepts that the derived differential is greater than the historic average differential if all days are considered regardless of whether balancing action was taken. However, in answer to the point raised by Scottish Power, the derived differentials are smaller than the average differentials that have been set as a result of Transco balancing actions.

Transco confirms that the differential values that would be implemented by this proposal would be fixed and any change to the values would require a separate modification proposal. Although the values have been derived from the auction of Hornsea storage services the proposal is not intended to establish a linkage between the price for such services and imbalance cashout. Transco considered that such a linkage might have an adverse influence on future storage service auctions.

In the proposal Transco indicated that this change is expected to represent an interim measure. Transco believes that the use of the proposed values is appropriate in anticipation of a more fundamental review of the energy balancing regime.

Interaction with balancing tolerances

NEAGL feels that the proposal fails to consider the interactions that exist between Shippers' exposure to SMPs, the tolerance regime and Transco's energy balancing incentive. However, Scottish Power does not believe that the implementation of this modification would provide support for the extension of ITQs until a linepack service exists, or indeed the resumption of ITQs in the event of no tolerance or linepack service being available.

Aquila is of the opinion that tolerances should be removed. However, Aquila argues that if this proposal is implemented in January "holders of significant tolerance quantities will reap an undeserved reward as they will be incentivised to take an imbalance position on all days so as to take as much of the fixed differential as possible. It would only be logical for such players to price their gas just below the fixed differential, so as to sell it to shippers with no tolerance quantities." Aquila points out that shipper balancing behaviour would continue to be poor between January and April. Aquila is strongly of the opinion that changes to cash-out should only be introduced once tolerances have been abolished.

SSE notes that the tolerance regime will only be in force until 31 March 2001, after which tolerances will be removed. SSE believes that this, coupled with Ofgem's decision to implement urgent modification 0440 (cancelling auctions of tolerances to be effective after 31 March 2001) would suggest that it would be prudent to delay any further changes to the cash-out regime until after the impacts of the changes in tolerances have been realised.

Transco opinion

Transco believes that the continuing existence of significant imbalance tolerance has weakened the balancing incentive for shippers and may have encouraged shippers to adopt particular imbalance positions. The application of imbalance tolerances and the operation of the cashout regime are closely linked. However, Transco believes that both the implementation of Modification 0440 and the measures described in this proposal would contribute positively to the development of the regime and therefore that both should proceed.

Transco acknowledges the arguments made by Aquila that the implementation of this proposal ahead of changes to the tolerance regime may have disproportionate effects for different shippers. However, it can be argued that the current regime affords the same opportunities to utilise imbalance tolerance on any day where an SMP has been set and hence the implementation of the proposal should not lead to significantly increased adverse effects in the period until 1 April 2001.

Interaction with Transco incentive

SSE states that if it is considered that differential prices should be set on both sides of the market a better price spread could be achieved by changing the way that Transco takes action so that it operates within a tighter bandwidth and takes smaller, more frequent balancing actions. SSE notes that the cash-out regime is inextricably linked to Transco's system balancing behaviour and performance under the incentive. SSE considers it inappropriate to introduce changes to cash-out without considering changes to Transco's incentive at the same time.

Powergen agrees that the Transco incentive may have limited Transco's balancing actions to those that are physically necessary and therefore limited the setting of marginal cash-out prices. However, Powergen points out that this is consistent with the views expressed by most shippers during the original RGTA discussions, namely that Transco should not take an active role in the market. Powergen does not believe that a return to mechanistic and more frequent balancing is the answer and nor is encouraging Transco to enter the market purely to set an unattractive SMP.

Powergen believes that the parameters of the Transco incentive should be reviewed following implementation of the proposal as Transco's balancing role would be reduced, making it easier for Transco to gain from the incentive.

Dynegy would prefer a return to a regime in which Transco takes more frequent, smaller balancing actions on both sides of the market, maintaining a narrower bandwidth around a target value of linepack. Dynegy argues that this would negate the requirement for fixed differentials.

BGT points out that the current cash-out regime relies on Transco to take balancing actions to set the marginal prices for use in cash-out. BGT points to the Transco incentive and its behavioural effect of weakening the incentives for shippers to balance by encouraging Transco to take balancing actions at or close to SAP.

BGT points out that the interaction between the Transco incentive and this proposal would lead to a situation where Transco would be less likely to act if the marginal price set by the Transco balancing action was within the fixed differential. BGT suggests that the Transco incentive is revised simultaneously with introduction of this proposal.

SGD also identifies that implementation of this proposal might encourage Transco to take less balancing actions with consequent effect through the incentive package.

Transco opinion

The structure and parameters of the Transco incentive are currently subject to a separate modification proposal (0414) that is with the Energy Workstream for discussion. Transco acknowledges that there may be interactions between incentives for shippers to balance and the incentive package applied in respect of Transco's residual balancing role. However, Transco believes that a fundamental aim of the regime should be to incentivise shippers to balance and that this proposal should progress independently of modification proposal 0414.

Implementation date

SSE questions how price information would be provided to shippers if the proposal were implemented. EnMO noted that an implementation date of 1 January 2001 was unlikely given the process timetable. However, EnMO proposes to amend its systems by the end of January 2001 so that it might continue to provide real time price calculations if implementation of this proposal is agreed.

NEAGL is in favour of a reform to the cash-out mechanism once the effects of changes to the tolerance regime in April 2001 and the proposed changes to Transco's energy balancing incentive become evident.

Alliance states that it would seem "more prudent to wait and assess the impact of the reduction of balancing tolerances before the industry has to implement another change to the existing energy regime. The ongoing nature of such piece meal changes is of significant concern as modifications are being implemented before the industry has had the opportunity to fully review the impact of previous reforms."

Innogy would prefer to see any change to cash-out as part of a more comprehensive and coherent review of the energy regime.

Aquila raises concerns regarding the proposed implementation date of January as this would represent a mid year change to a major component of the commercial regime that may undermine the basis on which gas shippers have planned storage and gas purchases.

BGT recommends that a review should be carried out at some fixed time if this proposal is implemented and that the regime should be changed again if necessary. Such a review may then consider reform of the Transco incentive as well as the effect of sharper incentives on shippers with the end of the tolerance regime.

Transco opinion

The originally proposed implementation date of 1 January has now passed. However, Transco continues to believe that changes should be implemented as soon as practicable. A number of respondents point to the linkages between the cash-out regime, imbalance tolerances and the effect of application of a Transco balancing incentive. Particular arguments were made that a change to the cashout regime ahead of changes to the imbalance tolerance regime may introduce different effects for different shippers. Transco acknowledges the arguments made in respect of the timing of changes to the tolerance regime. An alignment with the changes to the tolerance regime would imply an implementation date of 1 April 2001. Transco does not believe that implementation of this proposal should be dependent on the outcome of ongoing discussions in respect of the Transco energy balancing incentive.

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

Not applicable

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Not applicable

14. Programme of works required as a consequence of implementing the ModificationProposal

System changes to AT Link are not required.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

EnMO has indicated that it could change its systems by the end of January 2001. Transco recommends an implementation date of 1 April to bring implementation of this proposal in line with changes to the imbalance tolerance regime. The period until 1 April would allow sufficient time for system changes to be made and permit implementation of revised operational procedures. In any event, Transco recommends a minimum lead time of 7 days between approval of this proposal and the effective implementation date.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this proposal be implemented.

17. 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.

18. Transco's Proposal

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

SECTION D OPERATIONAL BALANCING, TRADING ARRANGEMENTS AND ENERGY BALANCING INCENTIVES

Amend paragraph 3.1.1 to read as follows:

"….

(i) System Marginal Incentive Buy Price differs from the System Average Price; and

(ii) System Marginal Incentive Sell Price differs from the System Average Price.".

Amend paragraph 3.1.3 to read as follows:

"(a) ….

((SMIBP – SAP) / SAP) * 100

….

((SAP – SMISP / SAP) * 100

….

SAP is the System Average Price;

SMISP is the System Marginal Incentive Sell Price;

SMIBP is the System Marginal Incentive Buy Price

….".

Add text at paragraph 3.1.5 to read as follows:

(d) ….; New paragraph 3.1.5(d) added by Modification 0373.

(e) for each Day the "**System Marginal Incentive Buy Price**" is the higher of the System Average Price and the price in pence/kWh which is equal to the highest Market Offer Price in relation to a Market Balancing Action taken for that Day; and

(f) for each Day the "**System Marginal Incentive Sell Price**" is the lowest of the System Average Price and the price in pence/kWh which is equal to the lowest Market Offer Price in relation to a Market Balancing Action taken for that Day.".

SECTION F SYSTEM CLEARING, BALANCING CHARGES AND NEUTRALITY

Amend paragraph 1.2.1 to read as follows:

"Subject to paragraphs 1.2.2 and 1.2.5, for each Day:

(i) the "**System Marginal Buy Price**" is the greater of:

(a) the System Average Price plus 0.0287 pence/kWh; and

(b) the price in pence/kWh which is equal to the highest Market Offer Price in relation to a Market Balancing Action taken for that Day;

(ii) the "**System Marginal Sell Price**" is the lesser of:

(a) the System Average Price less 0.0324 pence/kWh; and

(b) the price in pence/kWh which is equal to the lowest Market Offer Price in relation to a Market Balancing Action taken for that Day;

(iii) the "**System Average Price**" for ….".

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Gas and Electricity Markets Authority Response:

> In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0433**, version **6.0** dated **19/01/2001**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **6.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:

   (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") 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 Authority 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 paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

   provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.

2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.

3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.

4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.