

Draft Modification Report
Removal of INS Charge
Modification Reference Number 0631
Version 1.0

This Draft 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

The Proposer stated:-

"Remove the INS charge introduced through M479."

2. Transco's Opinion

Transco does not support implementation of this Modification Proposal.

The Incentivised Nomination Scheme (INS) was introduced as a “first step incremental reform” of the gas balancing arrangements in October 2002. It was implemented in the context of concern about the efficiency of regime operation. It was recognised at the time that the scheme would be unlikely to address all of the concerns about regime operation but that it might have sufficient impact to avoid other alternatives, which, whilst they might have addressed operational concerns, were considered by many as having the potential to act to the detriment of trading efficiency.

Specifically INS was designed to:

- provide the residual system balancer with extra information that might improve the efficiency of its balancing action process;
- provide better incentives for shippers to achieve imbalances close to their nominations; and
- deliver better cost targeting by removing the “free option”.

It was recognised that INS did not directly address within-day flow rate variations. However, it was acknowledged that, if the incentives were sufficiently strong, then the incentive might encourage shippers to make arrangements to either procure gas via NBP trades or to have, and to have exercised, rights over gas deliveries so that they are closer to their intended imbalance position earlier in the day. If this turned out to be the case, then in aggregate gas flows onto the system should be closer to system design and operational assumptions.

Transco recognises the difficulties associated with assessing the performance of the regime and recognises that INS is a focus of great attention. This is not surprising, it was introduced as a “first incremental step of reform” and it is important that the industry should endeavour to establish its impact. Specifically it does introduce an exposure to shippers changing their nominated imbalance position and/or not achieving such final imbalance nomination used for INS charging purposes. The effect is to remove some elements of the “free option” available to all shippers under NGTA prior to implementation of INS. Various industry participants have indicated that the INS charges

are either too high or too low. Transco would be particularly interested to understand the extent to which INS has influenced shipper procurement, nomination and trading activity. Transco seeks views in responses.

Transco believes that many market participants are using the prompt gas market for far more than “fine tuning” of their imbalance risk mitigation strategies. This is evidenced by the large physical nomination against demand discrepancies apparent before and during the early part of the gas day that have become regular rather than occasional. This feature gives rise to input and offtake flow rate mismatches generating consequently increased utilisation of linepack. The commercial freedom afforded shippers may deliver benefits and opportunities in terms of market efficiency, but it is creating increased operational concern. Whilst this Modification Proposal seeks to effectively remove the INS incentive Transco would also be interested to receive respondents views as to how far the incentive might need to be increased before it would induce shippers to arrange either physical gas deliveries and offtakes and NBP Trade Nominations so that their NB10 nominations on AT-Link would be close to a balanced position either at 6am start of gas day, or at the day ahead stage late in the afternoon.

In its recent document “The gas trading arrangements Reform of the gas balancing regime Next steps April 2003 21/03” Ofgem propose that the effectiveness, or otherwise, of INS needs to be assessed to inform whether the scheme should be extended, removed or amended.

Transco welcomes a review of INS and its potential impacts on regime performance. Transco believes that the issue of regime performance needs to be considered in the broad context of the range of incentives within the commercial framework . This embraces the nomination regime, imbalance cashout, scheduling charges and INS arrangements. The strength and relativity of these components are a key determinant of regime performance.

However in the context of the stated objectives for INS Transco believes that the scheme has afforded shippers the opportunity to supply information to Transco about imbalance projections that shippers would otherwise not have been able to provide. This information informs the balancing decision making process and it is noticeable that system balancing volumes were lower this winter than in the previous winter. This might be considered to be a measure of improved efficiency.

Additionally the existence of the financial incentives will have provided better incentives for shippers to achieve imbalances close to their nominations. The differences between INS nominations and actual daily imbalances are generally very much smaller than the differences between nominated imbalance positions (derived from the AT-Link input, offtake and NBP Trade Nominations on the NB10 AT-Link screen) and actual daily imbalances. This suggests that INS is providing Transco with better information about expected end of day positions than other nomination information.

Furthermore INS might be considered to have delivered improved cost attribution that might be assessed as removing the “free option” that previously enabled shippers to change their imbalance positions without any financial consequence.

However, regrettably Transco has not been able to detect improved performance over the winter in respect of the linepack variation issue. Put quite simply, the current regime as it applied over the last winter still continues to deliver flow patterns that are not consistent with system design assumptions.

As Transco has outlined in its response to the Ofgem document it believes that there is significant opportunity for regime performance to further deteriorate. Therefore at this point in time, and without wider consideration to the development of the regime Transco considers it inappropriate to eliminate the financial incentive to shippers provided by INS.

Transco believes that the current regime needs to be considered in the context of the interaction between the various incentive arrangements. This includes the nomination regime, imbalance cashout, scheduling charges and INS. However Transco does not wish to introduce inappropriately strong incentives that might seek to generate high net cashflows into balancing neutrality which might create undesirable redistributive effects.

Transco believes that the industry should consider change, perhaps in the context of graduated incentives which are stronger over periods when the system might otherwise be expected to be under high stress. This might enable potential changes to be assessed in the context of both commercial and operational efficiency and any trade-offs there-between. The current regime has, and continues to, promote competition and effective trading.

Transco notices that trading volumes on the OCM continue to increase and that Transco's market share has reduced to single figure percentages. The daily balancing and allocation elements of the NBP concept are valuable features of the regime and should be retained. Transco will aim to facilitate such consideration with a view that the commercial regime should deliver physical flow rate changes which are sufficiently close to system design assumptions that they satisfy operational requirements.

Transco does not envisage that implementation of this Proposal would have any implications for the electricity regime. Transco would welcome identification of any implications in responses.

Whilst Transco will carefully consider representations Transco's initial view is that it is opposed to the implementation of this Modification Proposal.

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

Transco believes that implementation of the Modification Proposal would not better facilitate the economic and efficient operation of the system.

**4. The implications for Transco of implementing the Modification Proposal , including
a) implications for the operation of the System:**

Transco believes that the removal of the INS would be likely to have a detrimental effect on the operation of the system.

b) development and capital cost and operating cost implications:

Transco would need to amend systems and billing processes and therefore development costs should be expected.

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:

Should any costs be incurred these would be shared with Users in accordance with the relevant SO Incentive scheme.

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

None 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

None are anticipated.

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

No development issues are envisaged.

7. The implications of implementing the Modification Proposal for Users

Implementation of this Modification Proposal might be expected to lead to greater linepack utilisation which might trigger greater requirements for balancing activities which might lead to increased costs accruing to the community.

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 are envisaged.

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

Transco is not aware of any impact on legislative and regulatory obligations.

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

Advantages: (Identified by Proposer)

- Would re-instate the free option for all shippers.

Disadvantages:

- May lead to increased linepack variation and the associated consequences.

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

Representations are sought as part of the Draft Modification Report.

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

No such requirement exists in respect of the Modification Proposal.

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

No such requirement exists in respect of the Modification Proposal.

14. Programme of works required as a consequence of implementing the Modification Proposal

No specific programme of works is anticipated

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

Transco anticipate the change could be implemented at a few days notice.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not recommend implementation.

17. Text

No text is provided as Transco is not advocating implementation.

Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report

Signed for and on behalf of Transco.

Signature:

Nigel Sisman
Development Manager, Gas Balancing
NT & T

Date: