URGENT Modification Report
Revision of Supply Point Ratchet Charge Multiplier for Gas Year 2003/4
Modification Reference Number 0652

Version 2.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because of the financial consequences that a number of Users could face as a result of the Supply Point Capacity Ratchet rules that will apply from 1st October 2003. Hence, to mitigate these financial consequences, it is desirable that implementation date of this proposal should be no later that 1st October 2003 to align with the date on which Supply Point Ratchet Charges for Winter period 2003/4 could first be incurred.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Proposal agreed as Urgent	19th September 2003
Circulate proposal to Users requesting representations	19th September 2003
Representation Close-Out	24th September 2003
Final Modification Report to Ofgem	26th September 2003
Ofgem Decision Expected	29th September 2003

1. The Modification Proposal

For the period 1st October 2003 to 31st May 2004, to reduce the value of the Supply Point Ratchet Charge multiplier (the "ratchet premium") to 0.01, (current value 2).

2. Transco's Opinion

Transco is of the opinion that this proposal should be implemented with effect from 1st October 2003.

Transco's opinion, (and the rationale behind the raising of the proposal), has been formed by balancing preferable solutions (such as those discussed at the NT & T workstream, e.g. the use of Day 1 charges and Day 2 charges in a way analogous to the charges applied following a failure to interrupt), against a solution that is achievable in the limited time before ratchet charges may be incurred. In supporting implementation, Transco does not want to underplay the significance of the disadvantages, detailed in section 10. Transco's support for the implementation is based on the combined desire of all Code parties to ensure that the risk of potentially significant ratchet charges is removed before the event rather than having to resolve the matter retrospectively.

On this basis, although Transco is the Proposer, it would like to record that its support is entirely conditional on the transitional nature of the proposal. Should the Authority align with Transco's opinion and approve this proposal, Transco believes that implementation should trigger a review of the incentive charge regime that under-pins the booking of Supply Point Capacity at Firm DM sites so that this issue does not reappear in 12 months time.

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

The purpose of the proposal is to provide a temporary solution to the issue of repeated breach of a Supply Point's Provisional Maximum Capacity ("PMSOQ") and the associated financial consequences. This proposal provides a pragmatic solution to the issue of repeat ratchet charges in the short term by retaining a modest incentive over the Winter, while giving Users the opportunity to resolve individual Supply Point issues over the medium term. Consequently, Transco is of the opinion that implementation would serve to facilitate a less risky and therefore more competitive environment for Users to operate.

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

a) implications for the operation of the System:

There would be no implication for the operation of the system.

b) development and capital cost and operating cost implications:

Transco believes that implementation would not result in any additional costs being incurred.

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:

No special cost recovery arrangements are envisaged.

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

Transco does not believe that this proposal would have any effect on price regulation.

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

During discussions a number of Users intimated that should this proposal not be implemented, Transco's contractual right to charge ratchet charges, (which for a number of supply points, using the current multiplier, would exceed £1m), may be the subject of a legal challenge. In such circumstances, the timely recovery of these charges would be put at risk.

Consequently, Transco believes its level of contractual risk would be reduced by implementation.

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

Implementation would require Transco to incorporate a minor change to the relevant billing system.

Transco has not been made aware of any implications for User systems. Transco has no reason to believe there would be any implications for Users since the functionality change required for implementation is on Transco's billing system.

7. The implications of implementing the Modification Proposal for Users

Where a User's offtake at a Supply Point exceeds either the registered Supply Point capacity, or the PMSOQ, the ratchet charge levied on the User would be reduced by a factor of 200, relative to the current regime.

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

During discussions at the NT & T workstream, Users intimated that some gas supply contracts contain back-to-back provisions that would result in consumers being liable directly for ratchet charges. Should this proposal be implemented, consumers would benefit since the charges passed through would be reduced significantly.

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

- The value of the multiplier (0.01) was arrived at during discussions at the NT & T workstream held on 17th September 2003. The view of the workstream was that ratchet charges resulting from the application of a reduced multiplier would be proportional, (although not equal to), to the avoided capacity charge and continue to provide an incentive, albeit reduced, to book supply point capacity appropriately.

- The temporary nature of the proposal avoids the possibility of severe financial hardship for a number of Users and/or end-consumers. Additionally, implementation would provide time to review the relevant Network Code rules and develop a more sustainable solution in the medium term.

- The rule change proposed in this proposal represents a pragmatic solution that Transco is confident it can implement in the extremely short window between the time of writing and the commencement of the 2003 Winter period.

Disadvantages

- A multiplier of 0.01 accounts fully for the avoided capacity charge only where a breach of PMSOQ is persistent and consistent. Where the offtake profile is not “flat”, with a low ratchet multiplier, a number of Users will pay less in capacity charges than if the capacity had been booked from the outset of the Winter period.

- Implementation could, theoretically, present Users with firm DM Supply Points in their portfolios a “wind-fall” gain as, in accordance with the rules, they would be permitted to reduce SOQ of a Supply Point to a level equivalent to the maximum quantity offtaken at the supply point during the previous Winter (the "bottom stop rule") and opt to run the risk of incurring reduced ratchet charges. Any capacity charges avoided in this way would be passed through to all Users by the K mechanism in the subsequent formula year.

There are two factors that serve to mitigate these disadvantages; first the proximity of the proposed implementation date to the Winter period gives limited time for Users to reduce capacity registrations. Secondly, the existence of the bottom-stop SOQ rule means that SOQ reductions would provide only a short lived, marginal benefit. This is further mitigated by the fact this is a transitional arrangement.

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

Nine representations have been received in respect of this Modification Proposal, all nine are supportive of the proposal although, in the case of three, support is qualified.

The Users that submitted representations are as follows:
BP Gas Ltd.
British Gas Trading Ltd. ("BGT")
EdF Energy Plc
Innogy plc
Powergen UK Plc
Scottish Power UK Plc ("SP")
Shell Gas Direct
Statoil (UK) Ltd.
Total Gas & Power Ltd.

Many of the representations make reference to the severity of the charges that could result from repeated breaching of the PMSOQ and the consequential application of the ratchet charge provisions. Some shippers go on to describe the charges that would be generated in such circumstances as "*punitive*" (Shell, Statoil) and may be "*penal*" (Powergen, BGT). Shippers, such as EdF, stated that they believed that since repeat ratchets charges occur due to a mix of circumstances, ranging from under-booking of SHQ, (and hence the resulting PMSOQ not being appropriate for the maximum daily offtake), to a delay in the completion of "Siteworks", it "*cannot agree that the existing level of Ratchet Charges can be justified.*"
Transco response: Transco too has some concerns over the proportionality of the incentive charges for persistent PMSOQ breach, hence its willingness to consult at short notice on this matter.

Some shippers expressed their concerns that the reduction of the multiplier to 0.01 would weaken the incentive for DM shipper to book supply capacity appropriately. This concern was raised in the representations from Innogy and SP
Transco response: as stated earlier in this report, Transco too has concerns that this may be the case. However, other provisions in the Code should ensure this effect is minimised.

BGT made reference in its representation to other solutions that could serve to resolve the issue, such as the concept of Day 1 and Day 2 charge for SOQ breaches.
Transco response: Transco is aware that more elegant solutions to this issue than the one proposed exist and looks forward to discussing these should a review of these rules take place. The solution proposed represents a pragmatic approach that resolves the imminent concerns of some DM shippers: given more time, the proposal would probably not be the preferred solution. However, Transco concurs with Shell's comments that even this simple solution serves to better facilitate the relevant objectives by "*ensuring that effective competition is not undermined by disproportionate charges.*"

Almost all of the representations make reference to the fact that it is wholly appropriate for the proposal to be time bounded and that implementation should be the forerunner to a wider review of the business rules in this area of the Network Code. Additionally, many of the representations request that monitoring of SOQs should take place over the winter to ensure that any inappropriate manipulation of the SOQ values is recorded.
Transco response: Transco concurs entirely with this view that only the Transition Document of the Network should be modified and the effect of implementation be limited to the forthcoming winter. Additionally, Transco believes that monitoring of shipper behaviour, regarding SOQ setting, would assist the development process, should a review be undertaken.

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

This modification is not required to facilitate compliance with safety or other legislation.

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

This modification is not proposed as a result of changes to the methodology established under Standard Condition 4(5).

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

Transco would be required to modify its billing system by incorporating the revised ratchet charge multiplier.

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

The system change is relatively minor and Transco envisage that the proposal could be implemented with effect from 1st October 2003, provided a Transco is advised of a decision no later than 29th September 2003.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommendation is that this proposal is 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

Transition Document

The following should be added to Part 2 of the Transition Document as a new paragraph 8.1.14:-

"8.1.14 B4.7.6 For the purposes of Gas Year 2003/4, the multiplier set out in each of paragraphs (i) and (ii) of Section B4.7.6 shall be 0.01, rather than 2."

Signed for and on behalf of Transco.

Signature:

Sharon McLaughlin
Customer Services Manager

Support Services

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 **0652**, version **2.0** dated **26/09/2003**) 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 **2.0**.

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 <u>(whether such approval is actual or deemed by effluxion of time)</u> 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, <u>had it not been repealed, would</u> 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) <u>or 2(2)(b)(ii)</u> 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.