Modification Report
Revised Ratchet Regime for Breaches of Provisional Maximum Capacity - Transco alternative
Modification Reference Number 0684a

Version 2.0

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

BP Proposal

This proposal addresses two areas: the incentivisation of shippers to book an appropriate SOQ for Firm DM Supply Point Components that breach their Provisional Maximum Capacity (PMC) and to replace this incentivisation where a shipper is seeking to book an appropriate SOQ, but is constrained by other industry processes over which he has no control – the assessment of the network to support the additional capacity requested, the development of a site works quotation where appropriate and the lead time and construction time associated with the site works quotation.

Ratchet Incentivisation Regime

Any Firm DM Supply Point Component that consumes more than its Provisional Maximum Capacity (PMC) on any day during a calendar month during the period 1st October to 31st May will be subject to this ratchet regime.

In any month within the relevant period where gas is consumed in excess of the PMC on any day or days at a Firm DM Supply Point Component the shipper shall be liable for a ratchet charge. Where the SOQ of the Firm DM Supply Point Component is below the PMC the SOQ of the Firm DM Supply Point Component shall be set to the PMC for the gas day following the breach. The charge shall be the product of the Ratchet Charge and a multiplier. The Ratchet Charge shall be the difference between the annual capacity charge for the SOQ at the maximum daily usage in that month and the annual capacity charge for the SOQ on the 1st of the month in question. The multiplier is [1] (one).

Requesting SOQ Increase

A request for an increase in SOQ above the PMC of a Firm DM Supply Point Component will require an assessment to be carried out to determine that the network is capable of supporting this load under the applicable design criteria. This currently takes 12 working days. During this period the shipper can not manage their exposure to additional breaches of the PMC. The application of an incentive where the person being incentivised can not act on that incentivisation is not appropriate or reasonable. However, as the Firm DM Supply Point Component is making use of the additional capacity the shipper should be charged for the use of the system. A Premium Daily Charge relating to the normal daily capacity charge for the SOQ requested by the shipper uplifted by [10%], less the daily charge for the SOQ of the Firm DM Supply Point

Component should be levied during this period. This charge should be waived for any day in this period which coincides with a day covered by the Ratchet Incentivisation Regime.

Where the result of the assessment of network capacity is that the requested SOQ is available the PMC and SOQ for the Firm DM Supply Point Component should be set to the requested SOQ for the gas day following the result of the analysis – 13 Days after the request for an increase in SOQ is submitted. Where this occurs within a month covered by a payment under the Ratchet Incentivisation Regime, daily capacity charges at the new rate based on the revised SOQ will commence from the 1st of the month following.

Where the result of the assessment of the network capacity is that site works will be needed to provide the additional capacity the shipper needs a short period in which to assess the long-term requirements of the site in which the Firm DM Supply Point Component is contained. The service level for production of a quotation for site works of this nature is 12 days. Such quotations are valid for acceptance for 90 days. Therefore, a reasonable tightly constrained period for obtaining authorisation to proceed with the appropriate site works would be 36 Days (comprised of 2 Days to determine requirements after notification that site works are required, 12 Days for the production of the quotation, 22 Days to obtain authorisation to proceed from the end consumer {equivalent to 30 calendar days}). During this period the shipper is working to manage their exposure to the Ratchet Incentivisation Regime charges and as such should not be exposed to these charges. Rather, they should be exposed to the Premium Daily Charge.

In summary, where a request for an SOQ increase is made and approved the shipper should be charged at the Premium Daily Charge until the Firm DM Supply Point Component SOQ is reset, allowing for days already covered by a Ratchet Incentive Regime charge; and where a request for an SOQ increase is made and requires site works, the Premium Daily Charge should be applied for 48 Days, allowing for days already covered by a Ratchet Incentive Regime charge.

Acceptance of Site Works Quotation

Once a shipper accepts a site works quotation to carry out site works to make the necessary capacity available under the applicable design criteria, they have discharged their responsibilities to the best of their ability and from this point should no longer be subject to charges under the Ratchet Incentivisation Regime, but should be subject to the Premium Daily Charge for any remaining relevant period until completion of the site works.

Transco Alternative

Where in a month[(1)] a Supply point offtakes more in a day than the PMSOQ, the ratchet charge will be waived except for day of the month on which the maximum breach occurred.

[(1)] applied, as now, only during for months October to May inclusive.

2. Transco's Opinion

Transco's proposal was raised as an alternative to Modification Proposal 0684, raised by BP Gas Marketing Ltd ("BP").

Both proposals propose solutions to the issue of repeat ratchet charges for Firm DM Supply Points offtaking in excess of their Provisional Maximum Supply Point Capacity, ("PMSOQ", referred to in BP's proposal as "PMC").

Transco's view is aligned with BP's in so far that the current drafting of the Network Code has the potential to generate significant charges where the circumstances described above occur. The principal difference between the proposed solutions lies in the information flows and procedures required to implement.

Transco's proposal is to levy a monthly charge equal to the highest daily ratchet charge in a month[(1)] where there is a daily offtake of gas above the Supply Point Capacity, (frequently referred to as "SOQ"), where the SOQ is greater than or equal to the PMSOQ. This provides a simple charging mechanism that generates realistic charges that are higher than would be applied for a simple SOQ-increasing ratchet but fall short of the aggregate charge that would be generated by the application of the repeat ratchet rule for breaches of PMSOQ. Transco believes that the monthly charge, while more severe than an SOQ-increasing ratchet charge, is appropriate bearing in mind that the Supply Point is operating in excess of the pre-agreed maximum daily offtake. In such circumstances, Transco may be required to deploy additional resources to ensure the security of the gas network is not being prejudiced. For the avoidance of doubt, in the event that the Supply Point offtake was having a detrimental effect on the network, Transco would isolate the Supply Point using its rights under the Gas Act or use Network Code rights to interrupt Supply Points in the localised area.

Transco's principal concern with BP's proposal, and its associated complexity, is that it endorses the premise that breaches of PMSOQ can only be managed retrospectively. Transco is of the opinion that, if managed proactively, the incidence of repeat ratchet charges could be significantly reduced or avoided altogether.

To illustrate this point, the majority of the Supply Points identified as at-risk of incurring repeat ratchet charges during this current Winter, discussion of which prompted the development of Modification Proposal 0652, have not had SHQ or SOQ increase requests submitted subsequent to its implementation. Transco believes that where site-works are required, the intervening months would have presented an ideal window of opportunity to initiate SHQ or SOQ increases at these Supply Points. However, the anticipated activity has not been evident to date.

Many of the representations comment on the importance of correct incentive setting to remedy situations where gas is being offtaken from the system at rates in excess of those approved by Transco. Transco would have envisaged that any risk of being in contravention of Section G of the Network Code and / or Condition 2 of the Shipper Licence would have been sufficient incentive for the initiation of appropriate remedial action.

Transco's primary concern is that Offtake Rates in excess of the pre-agreed maximum value should be advised to Transco so that the System can be analysed to ascertain whether or not the new load could be supported. Where the new load can be supported, the SOQ should be increased and transportation charges should be amended to reflect the new values; where the new load can not be supported, this proposal simply seeks to ensure that inappropriately high charges for the use of system are not levied while the situation is in the process of being rectified. Irrespective of whether an application for an increased Offtake Rate has been submitted to Transco or not, the shipper is responsible for the offtake. BP's proposal implies that once an increases request has been submitted it has discharged its responsibilities and the shipper should face reduced system use charges. The submission of an Offtake Rate increase request does not alter fundamentally the contractual position and Transco is keen to ensure that such an act should not be construed as it giving approval, tacit or otherwise, for the supply point to continue to offtake in excess of the agreed maximum. Certainly, such an act would not prejudice Transco's right to take safety related remedial action.

As stated above, Transco's concern in this matter is ensuring that shippers seek approval for increases in offtake rate. Transco is of the opinion that its proposal, rather than BP's, is more likely to result in shippers taking appropriate action.

In summary, Transco is of the opinion that its proposal should be implemented in preference to BP's as it offers a less complex solution to matters that, in any event, the shipper is obliged through contract and license to resolve.

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

The purpose of both proposals is to provide a solution to the issue of repeated breach of a Supply Point PMSOQ and the associated financial consequences.

Transco's proposal provides a pragmatic solution to the issue of repeat ratchet charges which maintains an incentive-based charging structure while retaining the ratchet mechanism with moderated charges, thereby maintaining an incentive for Users to resolve individual Supply Point issues.

BP's proposal, similarly, provides a method of moderating repeat ratchet charges but introduces additional complexity by linking them to the siteworks process.

Transco is of the opinion that implementation of either proposal would solve the problem of excessive charges being levied on a shipper. Hence both proposals would serve to maintain an incentive structure that would provide a competitive and commercially sound environment for shippers to operate.

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

a) implications for the operation of the System:

Transco does not believe that implementation would affect the operation of the system since implementation would simply revise the charges applied for use of system above PMSOQ. As

mentioned above, in the event that such offtakes of gas were affecting the operation of the system, Transco would have at its disposal a number of contractual rights and statutory powers.

b) development and capital cost and operating cost implications:

Transco believes that implementation of either proposal would result in only minor system development costs since the current proposed implementation plan for each of the proposals results in very low levels of systematisation. In terms of operating costs, Transco believes its proposal would result in lower operating costs than BP's proposal since the Transco proposal would require lower volumes of information having to be processed manually. Additionally, BP's proposed reduction in the ratchet multiplier would add to the complexities of the procedures.

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:

Transco accepts that any costs associated with implementation would be part of its opex and, consequently, no special provision for cost recovery would be required.

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

Implementation would not 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

Transco believes that implementation of either proposal would reduce its contractual risk, since the scope for challenge to the appropriateness of repeat ratchet charges would be reduced significantly.

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

Implementation of either proposal would require some changes to Transco's computer systems although the degree of systematisation would be reviewed depending on the volume of sites to which the new rules would apply and the current expectation is that either proposal could be implemented manually. Should Transco opt to systematise, it is of the view that a systematised implementation of BP's proposal would present significant difficulties due to the high interdependence to the siteworks process. A systematised solution to Transco's proposal would require a relatively minor modification to the system to suppress daily charges in favour of monthly charges.

Transco is not aware of any implications for User systems.

7. The implications of implementing the Modification Proposal for Users

Implementation of either proposal would reduce the exposure faced by the Register User at a Supply Point offtaking gas at a daily rate above PMSOQ.

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

No such implications have been identified.

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 such implications have been identified.

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

Advantages:

Both

- Both proposals serve to moderate the transportation charges associated with repeat breaches of PMSOQ.

Transco

- Transparent charging structure that would be straightforward to administer.
- Encourages shippers to be proactive in managing SHQs and SOQs.

BP

- Varies the level of charge depending on the actions taken by the shipper to resolve the problem.

Disadvantages:

Both

- Both proposals reduce the financial incentive to resolves problems associated with the accuracy and appropriateness of the SHQ and SOQ recorded against a firm DM supply points persistently breaching its PMSOQ.

BP

- Administratively complex requiring information to be passed between Transco's transportation business and Fulcrum.
- Reinforces the view that instances of PMSOQ breach and potential PMSOQ breach can only be managed retrospectively.

11. 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 5 Users:
BP Gas Marketing Ltd, EDF Energy, Powegen UK plc, Statoil (U.K.) Ltd and Total Gas & Power Limited ("TGP").

Three of the representation favour implementation of the BP proposal and one favours Transco's alternate proposal.

The principal concern of the respondents in favour of BP's proposal over Transco's is that the levying of charges not tied into the resolution process does not give the shippers a financial incentive to resolve the matter that gas is being offtaken at a supply point in excess of the quantities advised to Transco. In a similar vein, the respondents go on to say that Transco's proposal does not recognise the extent of any remedial action undertaken by the shipper.

TGP and BP also pointed out that a 12 month contract period, and other complexities associated with the retail side of the industry, do not always allow sufficient time, or provide sufficient information, to allow anything other than a reactive approach to PMSOQ breaches.

With respect to the representation in favour, the respondent concurred with Transco's view that the alternative proposal offered a pragmatic solution to PMSOQ breaches and noted Transco observation that remedial work at supply points with histories of PMSOQ breaches has not been forthcoming in the window of opportunity offered by the implementation of Modification Proposal 0652.

Statoil suggested that because both proposals had problems associated with them, it was able to support neither, although suggested that it could support a simple solution, if a process could be developed whereby the shipper could claim-back repeat ratchet charges, to offset the cost of investment, where it could demonstrate it had increased the SOQ to the maximum breach level within a "set time-scale".

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

Implementation is not required to facilitate such compliance.

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

Implementation is not required to facilitate such change.

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

Bearing in mind the limited number of sites (circa 20) that it is expected that the new rules would apply, it is expected that the system changes would be limited to output reports to identify PMSOQ transgressions, and hence relatively minor. It is expected that practical implementation of either proposal, that is a requirement to revise transportation charges, would involve primarily the development of non-systematised procedures to filter out, manipulate and suppress certain charges, and could be developed prior to 1st Oct 2004.

It is envisaged that a programme of works, including system changes, developing procedures, training and testing would take of the order of 6 to 8 weeks to implement.

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

This proposal could be implemented to take effect immediately, although it would have not any practical effect until 1st Oct 2004.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that its proposal should be implemented in preference to BP's although Transco's sees some merit in the adoption of a "claim-back" process described in principle by Statoil, although a certain proportion would have to be retained to reflect the premium nature of these unauthorised peak system flows.

Transco would be willing to develop and reconsult on the principle of this amendment, or should Ofgem decide to direct in line with Transco's recommendation, would support a further modification proposal that captured the sentiments of Statoil's proposed enhancement.

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 B - System Use and Capacity

Amend paragraph 4.7.1(b) as follows:

subject to paragraph 4.7.11, the User shall pay a charge…

Amend paragraph 4.7.7 as follows:

Subject to paragraph 4.7.11, the Supply Point…

Add new paragraph 4.7.11

Where on any Day(s) in any relevant Billing Period, on the occurrence of a Supply Point Ratchet the User's Registered DM Supply Point Capacity is greater than or equal to the Provisional Maximum Supply Point Capacity (the **"Relevant Day(s)"**), only the highest Supply Point Ratchet Charge incurred on the Relevant Day(s) in such relevant Billing Period shall be invoiced and payable in accordance with paragraph 4.7.7.

Signed for and on behalf of Transco.

Signature:

Peter Rayson
Commercial Manager - Customer

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 **0684a**, version **2.0** dated **11/06/2004**) 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 (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.