Draft Modification Report
Entry Capacity Allocation where Demand Equals Supply
Modification Reference Number 0695

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

To amend Network Code Section B2.6 to allow allocation of System Entry Capacity at the point where demand equals supply at the relevant step group that reflects the demand for capacity.

The Network Code sets out rules for the allocation of Quarterly System Entry Capacity (QSEC) at Aggregate System Entry Points (ASEPs) made available for sale in the annual invitations for System Entry Capacity. In such invitations capacity amounts are offered for sale as incremental amounts at pre-determined prices. The amounts offered and the relevant prices, are specified in accordance with Transco's GT Licence and Transco's Transportation Statement.

The Incremental Entry Capacity Release Methodology Statement (IECR) requires that the applicable quantity of release should be at the highest price step at where demand exceeds supply which is intended to maximize the capacity to be released. However, the Network Code requires that the Relevant Price Group Step which defines the Network Code quantity to be released should be (for ascending price schedules) the step price group when considering the incremental quantities specified in the annual invitation in ascending order, in respect of which the Step Price Group Quantity is first equal to or less than the Actual Available System Entry Capacity. For descending price schedules the relevant step price group is where the amount of capacity demanded is last equal to or less than that available.

At present it is considered that the Network Code capacity allocation rules adequately cater for scenarios where demand for supply is elastic and where demand is equal to supply. However where demand is inelastic (i.e. demand is constant over a number of price steps) and demand is also equal to supply at a price step it is considered that the present rules could seek to allocate capacity at a relevant step price group that does not appropriately match the price signal where demand equals supply. This situation is most likely to arise at New Entry Points where only one shipper is bidding for capacity.

It is considered that both the Incremental Entry Capacity Release Methodology Statement (IECR) and the Network Code should reflect that allocation should occur where demand equals supply i.e. where the signal for demand of capacity meets perfectly the supply available at the highest price step. The IECR is being clarified to deal with this point in a parallel review.

2. Transco's Opinion

Transco, as proposer, supports implementation of the proposal.

Transco believes that capacity should be allocated consistently with the other relevant provisions of the Network Code and the IECR. The IECR is being clarified such that the applicable quantity of capacity for release should be considered at the highest price step where demand exceeds **or is equal to** supply. The modification proposal would bring the rules in the IECR and the Network Code into line and would ensure that capacity would be allocated precisely at the price step where demand equals supply. Thus capacity would be allocated efficiently and the proposal would enable Transco to discharge its primary duty as a Gas Transporter as specified in its GT licence such that it operates its pipeline system in an economical and efficient manner.

The amendment has not had any material consequences to date because in the LTSEC auctions that have taken place so far the situation has not yet arisen where demand is inelastic and equals supply. The modification proposal is intended to cover any future situation where such a supply-demand scenario were to arise.

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

Transco believes that implementation of the modification proposal better facilitates Transco's relevant objectives particularly in terms of the economic and efficient operation of its pipeline system. The proposal would allow allocation of capacity at the price step where demand precisely equals supply i.e. where Transco has received the perfect price signal. Therefore the proposal would allow capacity allocation to take place at the cost reflective price of making that particular incremental volume of capacity available. This would enable economic investment decisions to be made thus achieving economic and efficient operation of its pipeline system.

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

a) implications for the operation of the System:

There are no implications for the physical operation of the System.

b) development and capital cost and operating cost implications:

No additional operating or capital costs are envisaged.

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 significant costs are anticipated

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

It is not anticipated that there would be any impact 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

There are no such consequences

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

Minimal systems development will be required to enable Entry Capacity to be allocated and released on the basis proposed. No implications are anticipated for the related computer systems of Users

7. The implications of implementing the Modification Proposal for Users

Transco believes that there should not be significant implications of implementing the Modification Proposal for Users.

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

Non-Network parties would not be affected.

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

None

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

Advantages:

The proposal should enable capacity allocation to take place in an efficient manner at the appropriate price step where demand equals supply

Disadvantages

Transco is not aware of any disadvantages

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

Representations for the Modification Proposal are invited.

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

Implementation is not required for this purpose.

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 having regard to any such proposed change.

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

There would not be a significant programme of works.

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

Circulate to Users requesting representations	1 July 2004
Representations close out	15 July2004
Final report issued to OFGEM	29 July2004
OFGEM decision	Early August

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of this Proposal.

17. Text

Draft Legal Text

Section B

Amend paragraph 2.6.5(b) to read as follows:-

"(b) the "**relevant step price group**" is:

(i) where a step price group quantity is exactly equal to the Actual Available System Entry Capacity, the step price group in respect of which the step price group quantity is exactly equal to the Actual Available System Entry Capacity at the step price in respect of the Actual Available System Entry Capacity; and

(ii) where paragraph (i) above is not applicable and paragraph 2.2.10(a) applies, the step price group, when considering the incremental quantities specified in the annual invitation in

ascending order, in respect of which the step price group quantity is first equal to or less than the Actual Available System Entry Capacity; and

(iii) where paragraph (i) above is not applicable and paragraph 2.2.10(b) applies, the step price group, when considering the incremental quantities specified in the annual invitation in ascending order, in respect of which the step price group quantity is last equal to or less than the Actual Available System Entry Capacity;"

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:

Richard Court
Commercial Frameworks Manager
NT & T

Date: