

**CODE MODIFICATION PROPOSAL No. 00xx**  
**"Entry Capacity Overrun Charges"**  
Version 0.1  
Draft

**Date:** 27/09/2006

**Proposed Implementation Date:** [01/04/2007]

**Urgency:** Non Urgent

**Proposer's preferred route through modification procedures and if applicable, justification for Urgency**

(see the criteria at

[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11700\\_Urgency\\_Criteria.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11700_Urgency_Criteria.pdf))

National Grid NTS seeks this Modification Proposal to proceed direct to consultation in accordance with Section 7.3 of the modification procedures in the UNC

**Nature and Purpose of Proposal (including consequence of non implementation)**

Under the current regime Users who are intending to deliver gas through an ASEP are provided with the opportunity to purchase NTS Entry Capacity, through one of the capacity auctions, which provides them with a right to flow gas onto the System. If a User delivers gas onto the System in excess of the level of NTS Entry Capacity they have purchased for the ASEP concerned then the User will incur an overrun charge.

The overrun charge is based on the quantity of gas by which the User has overflowed their capacity entitlements, multiplied by an overrun price. The overrun price is the greatest of four different price calculations applicable to the ASEP concerned:

- The first price is determined by taking the highest allocated bid price in any of the Annual, Monthly and Daily auctions for the relevant Day which is then multiplied by 8.
- The remaining prices are determined by calculating the average of the top 25% prices of the appropriate accepted offer, forward or exercise price for the relevant Day which is then multiplied by 1.1.

The intent of the overrun charge is to encourage Users to purchase NTS Entry Capacity and secure a right to flow gas onto the System which in turn provides National Grid with a signal as to how the System is intended to be used.

However, under certain circumstances this incentive is negated and could encourage Users to take up an overrun position due to conflicting financial incentives. This is explained below:

1. Under B2.12.3 (b), (c) and (d) the overrun price is determined by calculating the average price of the top 25% of Firm NTS Entry Capacity surrendered by Users during any constraint actions being taken and then that price is multiplied by 1.1.

However, this can result in a position whereby the User can have a buy back offer accepted, and the User could decide not to reduce flows at the ASEP. This could result in the User

taking an overrun position. However, due to the nature of the overrun price calculation, this could create a situation whereby the revenue generated from the sale of capacity can exceed any subsequent overrun charge thus providing a perverse incentive on the User to overrun.

2. Under B2.12.3 (a) the overrun price is determined by identifying the highest bid price relating to an allocated bid in any of the Annual auction (AMSEC), Rolling Monthly Auction (RMSEC) or the daily auctions (WDDSEC or DADSEC) and then multiplying the price by 8.

This creates the applicable overrun price. However, under certain circumstances the highest bid price can be zero (where the reserve price is set at zero for the ASEP in these auctions) which can then create a zero overrun price. This results in a possibility that a User could decide not to purchase NTS Entry Capacity and then deliver gas onto the System in excess of their capacity holdings and incur a zero overrun charge. Although the purchase of the capacity would have been at zero price National Grid NTS would have received the signal through the appropriate auction of the intended use of the system.

It is also possible that if no bids are received for capacity at an ASEP, with a reserve price greater than zero, then any subsequent flows would result in a zero overrun charge – regardless of the level of the reserve price.

The proposal is that the calculation for determining the applicable overrun price (B2.12.3) is amended to the greatest of one of the following;

- (a)  $(8 * A)$  where A is the highest bid price paid by National Grid NTS in relation to any capacity bid accepted in respect of the Day or the Gas Year in which the Day falls.
- (b)  $(1.1 * B)$  where B is the highest allocated offer price, forward price or option exercise price paid by National Grid NTS in respect of any Entry Capacity Management action taken in respect of the Day.
- (c)  $(8 * C)$ , where C is the highest reserve price under any invitation for the Day or Gas Year in which the day falls.

National Grid NTS believes that if this Proposal were not to be implemented then it would continue the perverse incentive on Users to not secure entry capacity when deciding to flow gas through an ASEP and therefore providing inaccurate signals of their intended use of the System.

This could also lead to Users selling their capacity back to National Grid during a constraint and the User taking an overrun position which could contribute to a failure by National Grid to resolve the constraint and/or generate higher constraint costs.

**Basis upon which the Proposer considers that it will better facilitate the achievement of the Relevant Objectives, specified in Standard Special Condition A11.1 & 2 of the Gas Transporters Licence**

National Grid NTS considers this Proposal would, if implemented, better facilitate the following Relevant Objective as set out in its Gas Transporters Licence:

- in respect of paragraph A11.1(a), the Proposal would provide the potential for National Grid NTS to more efficiently manage a constraint at an ASEP by removing the incentive on Users to overrun during a constraint where their accepted offers are within the top 25% of all accepted offers for the Day. The use of the marginal price for the calculation of the overrun price would remove any incentive for the User to offer back their entry capacity and continue flowing which would have the potential to lessen the level of constraint actions, and therefore reduce the constraint costs, required by National Grid to resolve any such constraint.
- in respect of paragraph A11.1 (a) the Proposal would enable National Grid NTS to economically and efficiently manage the pipeline system by removing the incentive on Users to not book NTS Entry Capacity by reducing the likelihood of the application of a zero overrun price. Thus ensuring that National Grid receive accurate signals through the capacity auctions of the Users' intended use of the NTS and allowing National Grid to plan accordingly.

**Any further information (Optional), likely impact on systems, processes or procedures, Proposer's view on implementation timescales and suggested text**

**a. Proposed implementation timetable**

**b. Proposed legal text**

**TPD Section B**

*Amend paragraph 2.12 to read as follows*

**"2.12 Overrun charges**

2.12.1 If for any reason the quantity of gas delivered by a User to the Total System at an Aggregate System Entry Point on any Day exceeds the User's aggregate Available NTS Entry Capacity (determined as Fully Adjusted), the User shall pay a charge ("**System Entry Overrun Charge**") in respect of NTS Entry Capacity at that Aggregate System Entry Point on that Day.

2.12.2 For the purposes of this paragraph 2.12, in respect of a User at an Aggregate System Entry Point for any Day, the "**overrun quantity**" is the amount by which the sum of the User's UDQIs on that Day in respect of each System Entry Point comprised in the Aggregate System Entry Point exceeds the sum of the User's Fully Adjusted Available NTS Entry Capacity.

2.12.3 The System Entry Overrun Charge shall be calculated as the amount of the overrun quantity multiplied by whichever is the greatest of:

- (a)  $(8 * A)$ , where 'A' is the highest bid price in relation to a capacity bid in respect of which NTS Entry Capacity was allocated following an invitation under paragraphs

- 2.2, 2.3 and 2.4 in respect of the Day, or the month or quarter in which the Day falls (as the case may be); and
- (b)  $(1.1 * B)$ , where 'B' is the highest accepted offer price, highest accepted forward price or highest accepted option price paid by National Grid NTS in respect of any Capacity Management action taken in respect of the Day; and
- (c)  $(8 * C)$ , where 'C' is the highest reserve price specified in an invitation under paragraphs 2.2, 2.3 and 2.4 in respect of the Day, or the month or quarter in which the Day falls (as the case may be);
- where (a), (b) and (c) are calculated by reference to information available to National Grid NTS at 02:00 hours on the relevant Day.
- 2.12.4 For the purposes of paragraph 2.12.3(b), in respect of an Aggregate System Entry Point:
- (a) the "highest accepted offer price" for a Day is the highest offer price paid by National Grid NTS pursuant daily capacity offers accepted in accordance with paragraph 2.10 in relation to that Day;
- (b) the "highest accepted forward price " for a Day is the highest price paid by National Grid NTS pursuant any Forward Agreement in relation to that Day; and
- (c) the "highest accepted option price" for a Day is the highest price paid by National Grid NTS pursuant any Option Agreement in relation to that Day.
- 2.12.5 Where on any Day National Grid NTS makes a Constrained Storage Renomination in respect of the Storage Connection Point of a National Grid LNG Facility then, subject to the proviso below, the System Entry Overrun Charge for a User in respect of the National Grid LNG Facility shall be zero for any overrun quantity but only to the extent and for such part of that Day that the implied rate derived from the Constrained Storage Renomination exceeds the implied rate derived from that User's Registered Storage Deliverability (as defined in Section Z) (in both cases for that LNG facility). This paragraph shall only apply in respect of a User where that User sends written notification to National Grid NTS within 3 Business Days of the relevant Day stating (a) that the zero rate is to apply; (b) the overrun quantity and the period for which it is to apply; and (c) reasonable evidence to support its claim.
- 2.12.6 System Entry Overrun Charges shall be invoiced and payable in accordance with Section S."

**c. Advantages of the Proposal**

National Grid NTS believes that this Proposal:

- better facilitates the efficient and economic operation of its pipeline system by removing the perverse incentive for Users to not respond to accepted constraint management actions;
- results in potentially lower constraint management costs on behalf of Users
- better targets constraint costs to those that create such costs;
- encouraging Users to book their capacity requirements to reflect their intended flows and providing National Grid with accurate signals for the use of the System;

**d. Disadvantages of the Proposal**

**e. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation**

National Grid NTS believes that this Proposal, if implemented, would better facilitate the operation of the System and enhance security of supply by removing the incentive on Users to overrun on a constraint day. It will allow National Grid to more efficiently manage a constraint and maintain security of supply and by encouraging Users to book their capacity requirements it will provide information to National Grid NTS regarding the Users intended use of the system and enable National Grid NTS to plan the operation of the system accordingly.

**f. The implication for Transporters and each Transporter of implementing the Modification Proposal, including**

**i. implications for operation of the System**

National Grid NTS does not believe this Proposal, if implemented, would adversely affect the operation of the System. By removing the incentive on Users' to overrun on a constraint day it will allow National Grid to more efficiently manage a constraint. In addition by encouraging Users to book their capacity requirements it will provide information to National Grid regarding the Users intended use of the System and enable National Grid to plan the operation of the System accordingly.

**ii. development and capital cost and operating cost implications**

National Grid NTS believes this Proposal, if implemented, would have cost implications related to the delivery of the required system changes. However, these costs are expected to be low.

**iii. extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs**

National Grid NTS believes that this Proposal, if implemented, would require it to recover the costs associated with the system development.

**iv. analysis of the consequences (if any) this proposal would have on price regulation**

National Grid NTS does not believe this Proposal, if implemented, would have any consequences on price regulation.

**g. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal**

National Grid NTS believes that the Proposal has no impact on the level of contractual risk that a Transporter is exposed to.

**h. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users**

National Grid NTS envisages that this will have an impact on the UK Link System if this Proposal were to be implemented.

**i. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk**

National Grid believes this proposal has no impact on Users for administrative and operational costs and level of contractual risk.

**Code Concerned, sections and paragraphs**

UNC TPD Section B

**Proposer's Representative**

David Adlam (National Grid NTS)

**Proposer**

Paul Roberts (National Grid NTS)

**Signature**

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