Final Modification Report
Re Modification Proposal No.5

Introduction

Premier Transmission Limited has prepared this report in accordance with section 8 of its Transportation Code Modification Rules.

PTL has received, from British Gas Trading, a modification proposal to change section 4.3.1 and 4.3.2 of its Transportation Code, which define the basis of determining the cash-out of out-of-tolerance Shipper imbalances. This proposal is attached and is also available on www.premier-transmission.com (Code Modifications).

British Gas Trading contends that the present methodology used for determining the cash-out is unreasonable and unduly penal. They believe that Shippers will remain sufficiently incentivised to balance their inputs and outputs by being exposed to a more benign cash-out factor. They propose that Balancing Charges in excess of the Exit Point Tolerance be calculated using the following factors:

Month	Positive Balance	Negative Balance
Jan, Feb, Mar, Dec	0.70	1.30
Apr, May, Oct, Nov	0.80	1.20
Jun, Jul, Aug, Sep	0.90	1.10

Present rate	Positive Balance	Negative Balance
All year	0.50	2.00

Premier Transmission Limited's Opinion

Premier Transmission Limited believes that the current basis provides sufficient incentive for Shippers to balance their inputs and outputs and that the incentive is not unduly penal. However, it notes that a similar (but not identical) proposal was implemented in the Bord Gáis Éireann Code of Operations in October 2002.

It should also be pointed out that both Bord Gáis Éireann and National Grid Transco have significantly larger systems in which to absorb significant line-pack changes.

With the connection of two CCGTs to the network, it is anticipated that there will be less seasonal profile and therefore it will be equally important that shippers maintain a balance during the summer months as it is during the winter months.

Premier Transmission Limited's Transportation Code provides Shippers with considerable flexibility with regard to making renominations. This is a significant tool available to Shippers to avoid imbalance charges.

It is not clear from British Gas Trading's proposal why the out of tolerance cash-out factors create such a problem; what has changed since the introduction of the Transportation Code to justify bringing about a reduction in the incentives or why shippers should be so disproportionately affected in the summer months.

Premier Transmission Limited is committed to the development of the Northern Ireland gas market and is receptive to suggestions that encourage this whilst at the same time incentivising Shippers to keep within balance. It is therefore willing to change the multipliers to test whether a different level would still provide sufficient incentive to balance. This is discussed further in the section 'PTL's Response to Representations Made'.

Analysis of Shippers' behaviour in the first twelve months since the implementation of the Transportation Code indicates that there is a continuing requirement to incentivise Shippers (or possibly their end users) to balance at the end of day. In the gas year ended 30th September 2002, there were 400 instances where the present four paired transportation contracts exceeded their exit point tolerance. This is broken down as follows:

Month	**No. of occasions outside tolerance**
October 2001	37
November 2001	49
December 2001	36
January 2002	26
February 2002	40
March 2002	42
April 2002	22
May 2002	12
June 2002	26
July 2002	46
August 2002	29
September 2002	35
Total	**400**

On a large number of these occasions there were significant end of day imbalances. In addition, there has been a noticeable difference between certain Shippers' (or their end users') within day nomination profile and actual take. Both these factors have led to the following balancing actions in the last gas year.

Month	No. of balancing actions
October 2001	1
November 2001	2
December 2001	1
January 2002	4
February 2002	7
March 2002	1
April 2002	2
May 2002	0
June 2002	0
July 2002	1
August 2002	3
September 2002	7
Total	**29**

Any significant softening of the out-of-tolerance charge would be giving Shippers and/or their end users the wrong message.

Third Party Representations Made

BGT supports the proposal. Phoenix Natural Gas Limited (PNGL) also supports the proposal. Northern Ireland Electricity has expressed concerns about the proposal. No other parties have made comments. Correspondence from these organisations has been published on the Premier Transmission website.

BGT responded to the Initial Modification Report as follows:

BGT acknowledges comments made by PTL in the Initial Modification Report and would like to take this opportunity to offer the following response and clarification.

The Code at present imposes Balancing Charges of 200% and 50% of the Daily Gas Price which can represent a major cost burden on Shippers. This cost burden could have a negative economic effect on a customer's viability and only creates additional risks for shippers.

These multipliers bear no relation to the costs incurred by PTL or indeed any market related costs for services. They are effectively a penalty as opposed to an incentive.

Shippers' risks from the present Balancing Charges can be summarised to include:

- Additional risk when using Natural Gas versus alternative fuels
- Financial implications as a result of the charges possibly affecting the viability of the Shipper
- No balancing action taken by the Transporter but imbalance charges will still apply.

The EC Commission in their Report Of The Implementation of the Electricity And Gas Directives (3/12/01) state as one of the main obstacles to full competition being "balancing regimes which are non-market based and which are unnecessarily stringent". BGT believes the current regime to be non-market based. Transporters in other European countries are adopting significantly lower multipliers than 200% and 50%.

For example, Fluxys have adopted 130% and 70% and Transco use an entirely different cost base (as alluded to in Modification Number 2).

BGT are not disputing the fact that some form of incentive is required to ensure that the shipper is not permitted to misuse the balancing gas in the system to the detriment of other shippers or PTL. The proposed changes to the Code will, along with the remaining incentives placed upon the shipper, maintain an appropriate incentive to balance.

BGT disagrees with PTL's statement that "the current….incentive is not unduly penal or anti-competitive". BGT believes that the current multipliers are very much in excess of any real or market related costs and hence are penal. In addition, BGT believes that PTL has sufficient tools available to it under the Code to manage the system in an "efficient and economic" manner. BGT also notes that PTL acknowledge that the Bord Gáis Éireann Code of Operations was recently amended to move away from a penal balancing regime to similar mechanism now being proposed in this modification.

BGT agrees with PTL's statement that "…it will be equally important that shippers maintain a balance during the summer months as it is during the winter months". The reason for proposing an increase in the imbalance charge for shoulder and winter months is aimed at providing an increased incentive on shippers to balance during periods of higher demand in the UK market. However, BGT would be willing to accept a year round multiplier equivalent to average of the proposed multipliers (0.80 for a positive balance and 1.20 for a negative balance) to improve simplicity of implementation and operation. Should this approach be unacceptable to PTL, BGT would be willing to review the operational performance under the new regime after a period of twelve months although we would wish to discuss and agree the criteria on which such a review would be based beforehand.

BGT recognises that given the length of time dictated by the modification process the proposed implementation date of 1st December has now lapsed. BGT is willing to accept PTL's proposed implementation date of 1st February 2003.

To conclude, BGT believes that the proposed modification meets the relevant objectives contained in PTL's Licence by maintaining the efficient and economic operation of the Network whilst promoting effective competition between gas suppliers using the Network by the introduction of a less penal imbalance regime.

Phoenix Natural Gas Limited's comments are:

Phoenix has no objection to the proposal made by Centrica to reduce the Balancing Charge levied above the allowable Exit Point Tolerance. Although this charge does not directly effect Phoenix at present it would become an issue for us should we obtain a shippers licence at a later stage.

We are in agreement with Centrica that the current calculation is unduly penal and the proposed reduced factors appear reasonable, while still incentivising shippers to provide accurate nominations.

Phoenix therefore holds the view that this proposed modification is preferable to the current methodology and so should be implemented.

Northern Ireland Electricity's comments are:

NIE are concerned that if this proposal goes ahead then PTL will have a reduced amount of income from Balancing Charges levied from Shippers who are causing the imbalance. Given that PTL are cost neutral with respect to balancing the system, if the shipper specific balancing charges are reduced then PTL will need to smear the recovery of any deficit from the whole SNIP Shipping community.

In your Initial Modification Report you make reference to 'end user'. NIE fall into this category but we would emphasise that are agreements are with PPL and we have no contractual arrangements with PTL. In addition Balancing Charges are defined as Code Charges under your Transportation Code and are therefore shipper specific. End Users should have no exposure to such charges.

<u>PTL's Response to Representations Made</u>

Premier Transmission Limited does not agree with the concept of relating cash-out rates to different seasons. It would prefer to use an annual multiplier. With two CCGT plants on the system in the future, it will be equally important that shippers maintain a balance during the summer months as it is during the winter months.

Analysis of Shippers' behaviour in the first twelve months since the implementation of the Transportation Code indicates that there is a continuing requirement to incentivise Shippers to balance at the end of day. The current proposal introduces an even more benign cash-out regime than exists in the Republic of Ireland, which Premier Transmission Limited cannot support.

However, Premier Transmission Limited is prepared to consider a softening of the out of tolerance cash-out multipliers, in order to determine whether a different level would still provide a sufficient incentive to balance. It will accept that cash-out of positive balances should be at 0.70 as this issue is not currently a major problem. However, as negative imbalances are of significant concern, it is only prepared to soften the cash-out multiplier at this stage to 1.70. Premier Transmission Limited accepts that it will need to make the case for any hardening of these tolerances in the future. Conversely, any further softening of the tolerances should be subject to a new Code Modification proposal and that this process should not take place until at least a year after implementation of the current proposal.

<u>Likely Implementation Date and Cost</u>

In the event that the Regulator is minded to support the proposal, Premier Transmission Limited has sought an initial opinion from its software developer as to the implications of implementing the proposal.

The proposal can be implemented immediately and at nil technical cost (i.e. excluding legal drafting and reissue of documentation) if there is a once off change to the out of balance cash-out factors (i.e. a year round multiplier). If the Regulator supports the concept of having three different charging periods (winter, summer and shoulder months), then Premier Transmission Limited would prefer that a more robust solution is built to mitigate the risk of producing incorrect bills. This could be achieved by a relatively simple system modification, with an estimated cost of £10,000 for the technical implementation. Premier Transmission Limited expect that this will take a minimum of three months to implement from the time the Regulator gives his agreement, to allow time for carrying out the modification and testing it before implementation.

Proposed Legal Drafting

If a year round multiplier is used, then the only change to Clause 4.3 will be any agreed multiplier rates. New definitions and interpretations are required if the concept of three charging periods is introduced:

"**Shoulder Month**" means any of the months April, May, October and November.

"**Summer Month**" means any of the months June, July, August and September.

"**Winter Month**" means any of the months January, February, March and December.

4.3 Balancing Charges

4.3.1 On any Day on which a Shipper has a Positive Balance a charge shall, subject to section 6.13.2, be payable to it of the aggregate of the value of:

(a) an amount of Balancing Gas up to or equal to the Exit Point Tolerance calculated at the Daily Gas Price; and

(b) any amount of Balancing Gas exceeding the Exit Point Tolerance calculated at the lower of (i) the Daily Gas Price multiplied by 0.70 where the relevant Day falls in a Winter Month, 0.80 where the relevant Day falls in a Shoulder Month and 0.90 where the relevant Day falls in a Summer Month; and (ii) the System Marginal Sell Price (as defined in Transco's Network Code) on the relevant Day.

4.3.2 On any Day on which a Shipper has a Negative Balance it shall, subject to section 6.13.2, pay an amount equal to the aggregate of the value of:

(a) an amount of Balancing Gas up to or equal to the Exit Point Tolerance calculated at the Daily Gas Price; and

(b) any amount of Balancing Gas exceeding the Exit Point Tolerance calculated at the higher of (i) the Daily Gas Price multiplied by 1.30 where the relevant Day falls in a Winter Month, 1.20 where the relevant Day falls in a Shoulder Month and 1.10 where the relevant Day falls in a Summer Month; and (ii) the System Marginal Buy Price on the relevant Day (as defined in Transco's Network Code) on the relevant Day.

Conclusion

- Although Premier Transmission Limited does not believe that there has been a demonstrable case for modifying the Transportation Code, it is prepared to consider some softening of the out of tolerance cash-out multipliers. Whilst it believes that the current basis provides sufficient incentive for Shippers to balance their inputs and outputs and that the incentive is not unduly penal or anti-competitive, it is prepared to accept a cash-out rate of 0.70 for positive imbalances and 1.70 for negative imbalances.

- Premier Transmission Limited wants to continue with an annual multiplier and does not support the introduction of charges corresponding to different seasons.

- Premier Transmission Limited does not believe that the proposed modification in its existing form would better facilitate the relevant objective as compared with the existing provisions of the Transportation Code.