August 1999

TRANSCO CONSULTATION REPORT ON PC49

Prices for unsold monthly capacity and floor prices for daily capacity auctions

1. Transco's Initial Proposal

Transco proposed that unsold monthly capacity should be offered at 1.5 times the cleared price up to 3 days prior to the month of use. Similarly it is proposed that daily firm capacity shall have a floor price set at 1.5 times the cleared price in the monthly auction. It is proposed that daily interruptible capacity should have a floor price of 0.2 times the cleared price in the monthly auction. In the event of a "pay your bid" auction, the multiples would apply to the second highest accepted price in the monthly auction.

2. Summary

In total there were 14 responses. A variety of multiples for calculating floor prices was discussed by the respondents. Table 1 below summarises the proposals for uniform price auctions.

Table 1.

Numbers of respondents favouring various floor prices

Multiple of monthly cleared price	1.5x	1.2x	1.15x	1x	0.5x	0.2x	0.1x	0
Unsold monthly capacity	4	2	1	3				
Daily Firm Capacity	7	1		3	1			
Daily Interruptible						5	1	6

One shipper supported the proposals when applied to low load factor terminals, but suggested that high load factor terminals should have a multiple of 1.1 for unsold monthly and daily firm capacity.

One respondent expressed concern that the proposed floor price calculation for daily firm capacity may not incentivise Transco to maximise capacity availability in the auctions. Transco do not believe that is the case. An initial monthly capacity allocation based upon Seasonal Normal Demand has been proposed in Network Code Modification 0350. It is thought that a widespread degree of acceptance of this approach has been gained through the discussions of the Reform of Gas Trading Arrangements.

A respondent asked for clarification that in the event that no bids are received the clearing price is deemed to be the reserve price. Transco can confirm that is the case.

3. Summary of responses

3.1 Floor price for unsold monthly capacity

Comments Received

One shipper is of the opinion that a multiplier greater than one for unsold monthly capacity will make over-recovery more likely. Another respondent suggested that the proposal may cause a restriction in capacity sold to shippers.

One respondent suggested that unsold monthly capacity should be transferred into the next round of the auction process.

It is suggested by one shipper that unsold monthly capacity should be offered in a series of auctions to be held every week from September 1999 through to March 2000. The conditions proposed for the initial auction would apply in each weekly auction. The proposer argued more frequent auctions would provide shippers with greater flexibility to manage their capacity requirements.

Transco's Response

The assertion by one shipper that unsold monthly capacity should not have a floor price multiplier greater than one is based on an assumption that Transco has proposed floor prices for monthly capacity that are designed to recover 100% of the proportion of Price Control Formula revenue previously ascribed to NTS entry charges. In fact, if monthly capacity auctions clear at the floor prices then entry capacity income to be counted against the price control formula revenue will be substantially reduced. For this reason positive multiples have been proposed for unsold monthly and daily firm capacity to encourage participation in the monthly capacity auctions.

Unsold monthly capacity will only become available if insufficient interest in monthly capacity was demonstrated at auction. However, in a series of four pay as bid auctions it is possible that the proposals could result in high bid prices setting floor prices for unsold monthly capacity. Transco will amend its final proposals to take account of such concerns. The final proposal shall include a floor price for unsold monthly capacity of one times the cleared price of the relevant monthly capacity auction.

Transco is of the opinion that carrying over unsold monthly capacity from one auction of a 25% tranche of capacity to a subsequent auction for a further 25% is open to abuse. Such a scheme may raise the possibility that large shippers can avoid an auction at little risk, knowing that they can bid for unsold capacity at a later date. Perhaps when a number of smaller shippers have withdrawn after gaining their desired quantities in earlier rounds.

Transco supports the principle of holding more frequent auctions. However, it is not considered feasible to introduce more auctions at this juncture, but will be considered as an option for development at a later date.

3.2 Floor price for daily firm capacity

Comments Received

A number of respondents have suggested that it would be beneficial to maintain a multiplier differential between unsold monthly and daily firm capacity in order to create incentives to purchase unsold monthly capacity in preference to daily firm capacity.

Transco's Response

Transco agree that this proposal has some logic in maximising take up of monthly capacity which contributes to Price Control Formula income and will amend its final proposals accordingly. Transco's final proposal for daily firm floor prices shall be 1.5 times the cleared price of the relevant monthly capacity auction.

3.3 Floor price for daily Interruptible capacity

Comments Received

One respondent maintains that there may be a case for an administration charge for daily interruptible capacity but no more. They proceeded to argue that daily interruptible capacity is of little value and that low prices should not have a detrimental effect on secondary market trading. One other shipper also maintained that interruptible capacity would not impact on secondary market liquidity. The same shipper also maintained that interruptible capacity is the only means by which shippers can acquire flexibility to react to changing patterns of supply and demand within day. It is therefore essential that the capacity is available at a market based price. Another respondent also suggested that the availability of daily interruptible capacity at low prices may aid capacity availability to cover offshore supply failure.

Transco's Response

Transco believes that there exists a tension between the proposed introduction of incentives to maximise daily capacity availability and a requirement to potentially offer services below cost. A floor price of zero for daily interruptible capacity would damage incentives to make the service available. However, Transco recognise the widespread concern about the proposal to introduce a charge for this service. In the light of this consultation Transco will amend its final proposal for an interruptible floor price multiplier from 0.2 to 0.1 times the cleared price of the relevant monthly capacity auction.

3.4 Pay as Bid Auction

Comments Received

A number of respondents suggested that in the event of a pay as bid auction, in order to mitigate the effects of tactical bidding, that the multipliers are based upon the average price of a percentage of capacity sold at the relevant monthly auction. Suggestions varied between the top 25% and top 20%. One of the respondents also suggested that in the event of pay as bid auctions the floor price multiples should be 1.1 for unsold monthly, 1.2 for daily and 0.2 for interruptible.

Transco's Response

Transco agrees that it would be inappropriate for shippers to set high floor prices by posting high bids for minimal quantities in the monthly capacity auctions. When determining the methodology for setting floor prices Transco has attempted to adhere to a principle that firm capacity should not be available elsewhere at cheaper rates than can be gained in the monthly capacity auction. Another principle in setting floor prices derived from pay as bid auctions is to enable shippers to avoid floor prices based on the highest, perhaps over valued, bid in the monthly auctions. In balancing the two considerations it is clear that in solving the latter problem of over valued bids one may begin to create the potential for floor prices at a discount to the prices that increasing numbers had willingly paid in monthly capacity auctions. In the light of these suggestions Transco propose that in the event of a pay as bid auction, accepted bids for the top 50% of capacity should become the basis for floor price calculations for unsold monthly and daily capacity.

3.5 Licence Conditions

Comments Received

Two shipper's consider that the proposals are contrary to the appropriate objectives of Transco's PGT licence conditions. In particular they were concerned that Transco sought to encourage participation in the monthly capacity auctions by introducing floor price multiples for unsold monthly and daily entry capacity services.

Transco's Response

A multiplier of 1.5 has been proposed for unsold monthly and daily firm capacity to encourage participation in the primary capacity auction. Floor prices that enable unsold monthly and daily firm capacity to be gained at no premium to monthly capacity increase risks that monthly capacity auctions could be undermined. Without such encouragement it is possible that shippers may choose to purchase daily capacity only. If such an instance is widespread then Price Control Formula income will be reduced and income destined for the capacity incentive scheme will be increased. In the main, income from daily capacity will be smeared back to shippers, based on a proposed 20/80 benefit share in the capacity incentive mechanism. However, low income from the monthly auctions may create under recovery based on application of the Price Control Formula. In this instance a potentially inefficient outcome is created whereby gas has flowed but most entry capacity charges are recycled back to shippers and in the following year charges for other transportation services are increased to correct for under recovery against the Price Control Formula.

3.6 Constrained Benefit

Comments Received

A number of respondents expressed concern that the proposal to sell capacity at LNG sites only on a daily basis will remove the present incentive to book LNG at Constrained sites.

Transco's Response

At Constrained LNG sites a benefit had previously applied for annual capacity booking. The Constrained benefit is a recognition of the beneficial effects upon transmission capability of holding quantities of LNG at sensitive locations for use during periods of severe weather and system difficulties. From 1 October 1999 the Constrained benefit shall apply to the rate of deliverability booked at a constrained storage site.

3.7 Capacity Availability at Non-Monthly Auction Locations

Comments Received

Clarification was requested by one shipper of which services will be available at locations where monthly capacity auctions do not occur. A respondent also indicated that he would welcome any proposals to enable capacity to be purchased for longer than one day from onshore and storage sites.

One respondent was of the opinion that at locations where monthly auctions are not available the floor price for daily firm services should be one times the daily rate of administered charges and zero for daily interruptible charges. The argument put forward was that a floor price multiple of 1.5 implied that shippers may have to pay more than the rate they would have paid had they booked annual capacity. Another respondent felt that at such locations it is reasonable to keep the same factor as proposed for other daily services for the sake of consistency.

Transco's Response

At locations that supply gas deemed to be above the Seasonal Normal Demand quantity or are of a size that restricts the potential for competitive bidding at that location, monthly capacity shall not be made available. At such locations daily firm and daily interruptible capacity shall be made available. The quantity of daily Interruptible capacity will be made available on a reasonable endeavours basis. The discontinuation of annual capacity services at these locations has meant that availability of interruptible capacity can no longer be based upon a measure of unused firm capacity. Transco believes that at the majority of onshore locations daily capacity will prove to be preferable compared with the former annual services.

Central to the calculation for this aspect of the proposal is an expectation that most of the terminals affected will produce gas for short durations. However, Transco accept that at some terminals the most economic option may previously have been to purchase annual capacity. It is not Transco's intention to drive up costs for shippers at those terminals and consequently will amend its final proposals to include a multiplier of 1 for daily firm capacity.

4. Final Proposals

Taking into account the views of respondents', Transco propose the following modifications to the charging regime, which will be applicable from 1 October 1999.

Unsold monthly capacity shall be sold at 1 times the cleared price obtained in the relevant monthly auction. (1 times the average of the top 50% by volume of accepted bids in a pay as bid auction).

Auctions of daily firm capacity shall have a floor price of 1.5 times the daily rate of cleared price obtained in the relevant monthly auction. (1.5 times the average of the top 50% by volume of accepted bids in a pay as bid auction).

Auctions of interruptible daily capacity shall have a floor price of 0.1 times the daily rate of cleared price obtained in the relevant monthly auction. (0.1 times the average of the top 50% by volume of accepted bids in a pay as bid auction).

At locations where auctions of monthly capacity are not offered, the floor price for daily firm capacity will be 1.0 times the daily rate of the published charges. Interruptible capacity shall be 0.1 times the daily rate of published charges.