

TRANSCO CONSULTATION REPORT ON PC62

Daily System Entry Capacity Floor Prices

1. TRANSCO'S INITIAL PROPOSALS

Transco consulted on proposals to amend the methodology for calculating floor prices for Daily System Entry Capacity (DSEC). The initial proposal was that the DSEC floor price should follow the same methodology as that applied to Monthly System Entry Capacity with the exception of applying a 25% discount to the adjusted administered charge rate. It has also been proposed that Interruptible System Entry Capacity (ISEC) floor prices should be set at 0.1 times the floor price previously determined for DSEC.

2. SUMMARY OF RESPONSES

In total there were twenty two responses, seventeen from shippers, three from users or user associations, one from an offshore producers association and one from another BG company.

Shippers	Alliance Gas Ltd	AGL
	British Gas Trading	BGT
	BP Gas Marketing	BPGM
	Conoco	Co
	Dynegy UK	DUK
	Elf Gas and Power	EGP
	Exxon Mobil	ExM
	Marathon	Mar
	Northern Electric	NE
	NPower	Np
	Powergen	PG
	Scottish Power	SP
	Scottish and Southern	SSE
	Shell Gas Direct	SGD
	Total GM	TGM
	TXU	TXU
V-is-on	V-Is	
Users or User Associations	AEP	AEP
	Corus	Corus
	MEUC	MEUC
Offshore Producers Assoc.	UKOOA	UKOOA
Other BG Companies	Transco LNG	LNG

Sixteen respondents (BPGM, ExM, TXU, Co, LNG, AEP, UKOOA, AGL, DUK, Mar, EGP, NE, TGM, SSE and SGD) welcomed the proposal to remove the

linkage that exists in the present methodology between the outcome of auctions for Monthly System Entry Capacity and the DSEC floor prices. That link ensured that the DSEC floor price would be set at a level equal to the weighted average price of the top 50% (by volume) of accepted bids in the relevant MSEC auction. Most respondents that commented on this aspect of the present methodology agreed that it had contributed to upward pressure on bid prices for MSEC in the recent auctions. Five respondents agreed with the proposal to set floor prices for ISEC at 0.1 times the DSEC floor price.

3. COMMENTS RECEIVED

3.1. Zero floor price

Six respondents (NE, V-Is, Np, Co, DUK and SSE) indicated that floor prices for daily capacity should be set at zero. One respondent (Co) does not feel that there is a need for DSEC floor prices when the NTS transportation costs are fully recovered by the sale of MSEC volumes. Two respondents (DUK, PG) draw attention to Transco's proposal to implement a revenue adjustment methodology and suggests that if implemented that will remove the need for anything other than zero floor prices. One respondent (BGT) suggested that the floor price for DSEC should be lower than that applicable for MSEC. To that end, it was suggested that daily floor prices should be zero whilst monthly floor prices could be maintained at a higher level.

Transco's response

Transco recognises that the proposals from respondents for zero floor prices are made as a general comment upon floor prices in all auctions of entry capacity. Transco has responded to this suggestion in more detail in its consultation report on PC61 (Monthly System Entry Capacity Floor Prices). Transco considers it inappropriate to introduce at this stage DSEC floor prices that are substantially lower than floor prices in MSEC auctions because of the possibility of a switch in bidding behaviour away from MSEC. That would increase the probability of under recovery against formula income whilst simultaneously increasing the possibility of over recovering against Transco's capacity incentive. A number of respondents have argued that such an outcome is unlikely. However, Transco continues to be concerned about the possibility, the likelihood of which increases if DSEC floor prices are set at a substantial discount to the floor prices for MSEC.

3.1.1. Parity of floor prices for firm capacity

Thirteen respondents (BPGM, ExM, Np, TXU, PG, BGT, UKOOA, AGL, Mar, EGP, TGM, SSE and SGD) questioned the appropriateness of the proposal to maintain floor prices for DSEC that are different from the floor prices applied in MSEC auctions. It has been suggested by one respondent (Np) that shipper desire for long term capacity rights will provide sufficient incentive for shippers to participate in the MSEC auctions. Another respondent (EGP) also explored this theme and concluded that Transco's justification of different floor prices (for MSEC and DSEC) was an over simplification because it is based upon an assumption that the two products, monthly and daily firm, are substitutable. They proceed to suggest that the majority of trading companies would have a preference to secure monthly capacity and are more likely to pay a premium to

reflect the risk of unpredictable daily prices/volumes and to a certain extent the additional administrative costs of participating in daily auctions.

Transco's response

Transco has sought to ensure that in the first instance shippers will seek to obtain MSEC to satisfy the majority of their entry capacity portfolio. That is more likely to foster an efficient outcome in that the appropriate level of formula income is more likely to be reached than would otherwise be the case. If Transco under recovers against its projected formula target then additional cost recovery would be required elsewhere on the transportation system. Transco may also be required to return excess income (greater than £25m) from sales of daily capacity to the successful MSEC holders. There arises the perverse possibility that income will be returned to MSEC holders whilst charges are simultaneously increased elsewhere to make up for an under recovery of entry capacity income.

Experience of shipper bidding for entry capacity since September 1999 has helped confirm to Transco that monthly and daily firm capacity are not perfectly substitutable products. That implies that for a similar price shippers would tend to prefer to obtain monthly capacity for the added benefits that it brings. A major component of those additional benefits, it has been suggested, is the avoidance of risks associated with daily price setting. The examination of substitutability leads Transco to consider it necessary to reassess the proposed level of DSEC floor prices.

It remains unclear to Transco what additional monetary value shippers place upon MSEC relative to DSEC. This question is of interest to Transco because a fixed DSEC floor price plus any additional values that are attached to MSEC may influence shippers when bidding for MSEC. However, if MSEC reserve prices are set with a view to recovering the majority of formula income, then Transco can see merit in reducing DSEC floor prices.

3.1.2. ISEC floor prices

The respondents that expressed a preference for a DSEC floor price of zero also suggested that the floor price for ISEC should be set at that same level. One respondent (DUK) commented that the floor price for interruptible capacity should not be higher than is necessary to cover administration costs.

Transco's response

Transco is pleased that a number of respondents supported its proposals for determining ISEC floor prices. Transco continues to be of the view that it is generally inappropriate to set zero floor prices where costs will be incurred in delivering that capacity. A floor price multiple of 0.1 is, in the view of Transco, a minimal charge that has not unduly discouraged the demand for booking Interruptible capacity. Transco therefore agrees that such a reserve price is appropriate for Monthly Interruptible System Entry Capacity (as proposed in PC63). Should Modification Proposal 0410 be implemented, then a Daily Reserve Price of zero would ensure that there is no artificial constraint on the release and purchase of capacity at the Day Ahead stage.

4. TRANSCO'S FINAL PROPOSALS

Having taken account of respondent's views, Transco proposes that with effect from 1 October 2000:

- **Daily System Entry Capacity Floor Prices should follow the same methodology as that applied for Monthly system Entry Capacity and that a 50% discount should be applied to the adjusted administered charge rate.**
- **If Monthly Interruptible System Entry Capacity is not available, Interruptible System Entry Capacity Floor Prices should follow the same methodology as that applied for Monthly system Entry Capacity and that a 90% discount should be applied to the adjusted administered charge rate.**
- **If Monthly Interruptible System Entry Capacity is available, Daily Interruptible System Entry Capacity Floor Prices should be zero.**