

## **TRANSCO PRICING CONSULTATION PAPER PC63**

### **Monthly Interruptible System Entry Capacity Floor Prices**

#### **Summary**

At present industry participants are discussing, as part of RGTA developments, the desirability of creating a Monthly Interruptible System Entry Capacity product. It has been suggested that options for the use of such capacity could be auctioned around the same time as the existing MSEC auctions. The ongoing Network Code discussions are at an early stage of development, although it is anticipated that if considered appropriate the services could be developed for use from 1 October 2000. This pricing proposal has been raised to coincide with the possible development of the new services. In particular the proposal suggests that floor prices for auctions of options should be set at zero p/kWh and that the exercise value of an option for use of interruptible capacity could be the same as the floor price for Monthly System Entry Capacity. Views are sought on the appropriateness of the above proposals.

## **Introduction**

In May 2000 Ofgem published a paper containing a number of 'strawman' proposals. The proposals were intended to stimulate discussion amongst industry participants about further development of the entry capacity regime for access to Transco's transportation system. One proposal within the strawman paper was for interruptible entry capacity to be made available in monthly blocks, as is presently the case for firm Monthly System Entry Capacity (MSEC). It was suggested that an option to use Monthly Interruptible System Entry Capacity (MISEC) might be auctioned at or around the same time as the periodic MSEC auctions. If a shipper then wished to make use of the MISEC upon which it had purchased an option, then the option could be exercised at a price that would have been known to him before he was required to bid for the option. This consultation paper is intended to be considered in tandem with discussions surrounding possible developments of the Network code to make available MISEC. It is also possible that, if options for a monthly interruptible product are developed, it may be deemed appropriate to sell options for Daily Interruptible System Entry Capacity (ISEC)

If agreement is reached on the need to develop MISEC, then it is probable that the product will be made available for use from 1 October 2000. That suggests an auction of options would occur at around the same time as MSEC auctions, completion of which is proposed (Network Code Modification Proposal 0399) by 31 August 2000.

## **Proposed Methodology**

Views would be welcome on the appropriate combination of floor prices should this approach be implemented. However, Transco would put forward for discussion an approach based on:

1. The floor price to be used in auctions of options for Monthly Interruptible System Entry Capacity would be zero p/kWh.
2. The floor price to be used in auctions of options for Daily Interruptible System Entry Capacity would be zero p/kWh.
3. The exercise value of an option to make use of a unit of Interruptible System Entry Capacity would be the same as either the floor price or average successful bid price of Monthly system Entry Capacity at the relevant Aggregate System Entry Point (ASEP) and relevant month of use.

## **Discussion of the proposed methodology**

Should the ongoing debate within the industry conclude that Monthly Interruptible Capacity is desirable, but that the release of options is not required then in such an instance Transco would seek to propose that the Monthly Interruptible Capacity floor price methodology should be the same as that proposed in Pricing Consultation Paper PC62 for Daily Interruptible System Entry Capacity.

Options provide a recognition of the 'insurance' service that Interruptible System Entry Capacity provides in that a shipper may wish to buy an option but not necessarily make use of it other than to reduce the risk of incurring overrun charges. To that end it would appear reasonable that shippers would attach low valuations to

the options. A zero floor price in a pay as bid type auction would best enable such an outcome.

Options could be exercised at a variety of prices. However, given the desire for certainty, which has been expressed in various RGTA debates, Transco believes that the price should be known in advance of the purchase of the option or, at the very least, the method by which the price will be derived should be known. To that end, if MSEC auctions were completed before the auction of the options, it would seem appropriate to set the exercise value with reference to the MSEC auction results. Alternatively if the value is set with reference to the MSEC floor prices then the possibility exists that the auction of options could be held at any time- before, coinciding with, or after the MSEC auctions.

Options are often used as a vehicle for avoiding extreme prices that would otherwise be incurred. In the case of entry capacity, an option may be exercised to avoid both high overrun charges and, in certain circumstances, high firm capacity charges. If the exercise price is set at a level above the floor price for monthly firm capacity, perhaps by reference to weighted average prices in MSEC auctions, then the exercise value for the interruptible product would in some instances be above firm capacity prices. This outcome can be avoided if the MSEC floor price is taken as the exercise value. The exercise value for the interruptible product will then be the same as the lowest possible valuation at which any shipper was able to gain a unit of firm capacity. All other accepted bids for firm capacity would have been at higher valuations.

On the other hand, basing the exercise price on the MSEC floor price may not be appropriate if the pricing methodology were amended to substantially reduce, potentially to zero, the MSEC floor price. This approach may be adopted if it is believed that sufficient competition exists to produce market related capacity prices for MSEC, but opens the possibility of very low cost interruptible capacity being available. This could in turn impact bidding behavior in the MSEC auctions and distort the allocation process.

#### **QUESTIONS FOR CONSULTATION**

**In the event of the development of Monthly Interruptible System Entry Capacity Options for use from 1 October 2000 Transco would welcome respondents views on the following:**

- 1. The appropriate level of floor price should options for Interruptible capacity be offered at auction**
- 2. The appropriateness of an exercise value for an interruptible option that is equivalent to the floor price or weighted average price of Monthly System Entry Capacity at the relevant ASEP and in the relevant month.**

**In the event of Monthly Interruptible Capacity being offered without prior use of options. It is proposed that the floor price methodology should be the same as that described in Pricing Consultation Paper PC62 for application at auctions of Daily Interruptible System Entry Capacity**