

TRANSCO CONSULTATION REPORT ON PC63

Monthly Interruptible System Entry Capacity Floor Prices

1. TRANSCO'S INITIAL PROPOSALS

Transco consulted on proposals to introduce a new methodology for charging for the use of Monthly Interruptible System Entry Capacity (MISEC). MISEC is the subject of Network Code Modification Proposal 0410 on which, at the time of writing, representations have been invited. In terms of pricing methodologies there are two possible forms that MISEC may adopt. The first is to auction quantities of MISEC on a similar basis to auctions of monthly firm capacity, where the price paid would be the accepted bid price. The alternative format would be to auction an option to use interruptible capacity in a specified month. An additional 'exercise' fee would then be payable when a shipper is deemed to have called upon its interruptible capacity.

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	
User Associations	AEP	AEP
	MEUC	MEUC
End Users	Corus	Corus
Offshore Producers Assoc.	UKOOA	UKOOA
Other BG Companies	Transco LNG	LNG

3. COMMENTS RECEIVED

3.1. General comments

One respondent (SP) considered that it was too soon to comment on the Pricing proposals and another (DUK) sought clarification about the possibility of a further consultation period if options are not pursued, the inference being that PC63 did not address the issue of auctions of a straight monthly interruptible product. Another respondent (EGP) noted that it is unfortunate that shippers are asked to comment on a pricing proposal for a service which is not yet defined.

Transco's response

Transco acknowledges that it is unfortunate that the precise definition of the proposed service has not been agreed prior to consultation on the form of pricing methodologies. Equally it has not been agreed that the Network Code should be modified such that such a service is provided. Transco is also aware that in some instances it is preferable for shippers to understand the pricing implications of various possible services before a final service is chosen for development. This tension between the timing of development of services and determination of pricing methodologies is an inherent problem when generating new services for early implementation. Transco has attempted to minimise the difficulties by issuing Modification Proposal 0410 in a similar time frame to the Pricing Consultation process.

PC63 proposed that in the event of MISEC being offered without the use of additional exercise fees the floor price would be the same as that applied to Daily Interruptible System Entry Capacity. Consequently Transco does not believe it is necessary to commence another consultation process for the sale of MISEC.

3.2. Zero floor price

Six respondents (V-Is, Co, AEP, DUK, TGM, and BGT) contend that floor prices should be set at zero for all categories of interruptible entry capacity. The arguments offered included the general principle that a zero floor price would avoid hindering the formulation of market values and that a revenue recovery methodology would remove the need for floor prices. Two shippers (BGT, DUK) argued that the value of monthly interruptible could be undermined if Transco is allowed to sell unlimited quantities of interruptible capacity or if Transco can sell daily firm services with the aim of causing interruption.

Transco's response

Transco continues to be of the view that it is inappropriate to set zero-rated floor prices where costs will be incurred in delivering that capacity. Transco believes a floor price multiple of 0.1 times DSEC for Monthly Interruptible System Entry Capacity is a minimal charge that is similar to existing floor prices for interruptible capacity. The floor prices for interruptible entry capacity will benefit from the background reductions in MSEC floor prices should the proposals contained in PC61 (Monthly system Entry Capacity Floor Prices) not be vetoed.

3.3. ‘Straightforward’ Monthly Interruptible Capacity

Seven respondents (TXU, PG, LNG, UKOOA, AGL, EGP and SGD) supported Transco’s proposal that should MISEC be auctioned without the subsequent application of an exercise fee then a floor price of 0.1 times the floor price for daily firm capacity would be appropriate.

Transco’s response

Transco is pleased with the level of support for this proposal. It would appear appropriate to Transco that if MISEC is sold without recourse to additional exercise fees then the floor price should be the same as that applied to auctions of Daily Interruptible System Entry Capacity. Identical floor prices would then reflect the same level of risk of interruption that is attached to both products.

Option and exercise concept

Eight respondents (NP, SSE, TXU, BGT, PG, Co, AGL and SGD) commented that this concept is too complex. In part, these objections to the principle of an exercise and option fee are based on doubts about the validity of holding an option to use a product that is by definition not certain to be made available.

Of the respondents that commented upon the appropriate floor price to be used in auctions of options, five (BPGM, ExM, AEP, UKOOA, Mar) suggested zero. No proposals for a higher floor price were volunteered.

With regard to the exercise fee a variety of views were offered. One respondent (ExM) suggested that the low risk of interruption meant that a 10% discount from average monthly firm capacity prices would be appropriate. Another respondent (NE) argued that because of the significant risk of interruption, the exercise fee should be less than 25% of the lowest 50% of accepted bids in the monthly firm auctions. It has also been argued (DUK) that the interruptible service is the only protection that the industry has against Transco setting its firm floor prices too high. One respondent (SGD) observed that the exercise price would in effect become the floor price and higher floor prices would drive up transportation costs. A number of respondents (UKOOA, Mar, TXU, BPGM) offered proposals for exercise fees that would be based on a discount from monthly firm capacity floor prices. Floor price multiples of 1.0, 0.9 and 0.75 were proposed.

Transco’s response

Transco notes the concerns expressed regarding the complexity of this aspect of the proposal. It is appropriate that the merits of the various strands of Modification Proposal 0410 are discussed as part of that consultation process. In general, respondents appear to be of the view that the floor price for auctions of options should be zero. Transco agrees that, in this instance, a floor price of zero would be appropriate.

Discussion about the appropriate exercise fee has proved to be interesting. The divergent views appear to be based upon shipper perception of the risks of interruption. Transco is of the opinion that interruption of entry capacity has not occurred to any significant degree to date. The quantities of interruptible capacity proposed in Modification Proposal 0410 are aligned to peak deliverability and are therefore consistent with the perception of a plentiful supply of interruptible

capacity which existed before 1 June 2000. The aggregate quantities offered in the winter period are not significantly oversold when compared to deliverable (firm) capacity, so it may be concluded that the risk of interruption will be low. Transco is led to conclude that the exercise value should approach firm prices.

3.4. Options impact upon daily interruptible capacity

One respondent (DUK) enquired about the impact that auctions of monthly options would have upon the daily interruptible and use-it-or-lose-it service.

Transco's response.

If MISEC is offered on an option and exercise basis it may be considered necessary to change the sale of daily interruptible capacity to the same basis. Failure to do so could introduce considerable complexity in the billing and constraint management processes. The desire to create tradable products would also require complex systems to be developed to track trades of both options and 'straight' interruptible capacity.

4. TRANSCO'S FINAL PROPOSALS

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

- **The floor price methodology for Monthly Interruptible System Entry Capacity (without options and exercise fee) 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.**
- **The floor price for auctions of options for interruptible capacity should be zero, and the exercise fee for use of interruptible capacity should be 0.9 times the Monthly System Entry Capacity floor price in the relevant month at the relevant entry point.**
- **The price of Unsold Monthly Interruptible System Entry Capacity (including options) following initial auctions will be the average of the top 50%, by volume, of accepted bids in ranked price order in the series of primary auctions at each entry point.**