# Modification Report
# Removal of the Zero Auction Reserve Price for Within-day Daily NTS Entry Capacity (WDDSEC)
# Modification Reference Number 0284
# Version 1.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

## 1 The Modification Proposal

*Where capitalised words and phrases are used within this Modification Proposal, those words and phrases shall usually have the meaning given within the Uniform Network Code (unless they are otherwise defined in this Modification Proposal). Key UNC defined terms used in this Modification Proposal are highlighted by an asterisk (*) when first used. This Modification Proposal*, as with all Modification Proposals, should be read in conjunction with the prevailing Uniform Network Code* (UNC).*

For clarification this Modification Proposal* covers the release of Daily NTS Entry Capacity* and the reserve price* (as detailed in section B2.4.13 (f) of the UNC TPD).

### Background

TO NTS Entry Commodity Charges* have increased year on year. This is due to growing under-recovery of TO Entry Capacity Revenue as a result, in part, of the large quantities of zero reserve priced capacity.

A reserve price is set for entry capacity released via auctions i.e. Quarterly NTS Entry Capacity* (QSEC), Monthly NTS Entry Capacity* via the annual and rolling monthly* (AMSEC & RMTTSEC) auctions, and Daily NTS Entry Capacity* via the day-ahead and within-day (DADSEC & WDSEC) auctions. A 33% discount is applied to the day-ahead daily firm NTS Entry Capacity auction reserve prices and the within-day firm NTS Entry Capacity auction has a zero reserve price (100% discount) in compliance with the NTS Licence obligation to hold at least one clearing auction for each Aggregate System Entry Point* (ASEP) for each day.

Currently, Daily Interruptible NTS Entry Capacity* (DISEC) is released with a zero reserve price at the day ahead stage and any resulting revenue is treated as SO revenue in accordance with the NTS Licence. This may be a factor in how much NTS Entry Capacity* Shipper Users* procure via the longer term auctions. The under recovery of TO capacity revenues via the NTS Entry Capacity Charges* impacts the TO Commodity Charge*. Any shortfall in the recovery of revenues by National Grid NTS* through entry charges is picked up through the TO Commodity Charge which is paid by all Shipper Users.

The Interruptible quantity to be made available is currently defined as the daily average unutilised firm capacity*, referred to as the ‘use it or lose it’ (UIOLI) quantity, plus a discretionary amount of NTS Entry Capacity which National Grid NTS determines and is currently released at zero price. National Grid NTS is concerned that this interruptible capacity can be released while firm capacity remains unsold, potentially making the interruptible capacity firm (if the unsold firm capacity is not procured) due to the low likelihood of

curtailment.

Industry concern about the increased TO Entry Commodity Charges led to National Grid NTS launching a fundamental review of the entry charging principles through the formation of the industry entry charging review group (ECRG).

A major priority identified by the review group was to reduce the significant quantities of NTS Entry Capacity which are auctioned at zero reserve price. This could be achieved by the removal of the firm NTS Entry Capacity discounts, and by amending the circumstances under which Daily Interruptible NTS Entry Capacity is released, hence reducing the circumstances under which Interruptible NTS Entry capacity is made available.

Amending the circumstances under which Daily Interruptible NTS Entry Capacity is released will be covered by a further UNC Modification Proposal.

**Proposal**

National Grid NTS proposes that the zero auction reserve price for Within-day Daily NTS Entry Capacity be removed from the UNC and that the reserve price be set out in the NTS Transportation Statement and calculated in accordance with the NTS Charging Methodology Statement.

For the avoidance of doubt, the zero reserve price for Daily Interruptible NTS Entry Capacity would still apply.

For the avoidance of doubt, on the day the release of Available Daily Capacity* (section B2.4.13(a) of the UNC) would be assessed throughout the Gas Day, on an hourly basis, via the firm daily allocation process. The Available Daily Capacity (other than the element of any additional Daily NTS Entry Capacity which National Grid NTS may choose to make available in its sole discretion) would be reduced within Day to take into account the implied hourly rate for the remainder of the Day.

## 2 User Pays

### a) Classification of the Proposal as User Pays or not and justification for classification

No changes to xoserve systems or processes have been identified and therefore the proposal is not a User Pays proposal.

### b) Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification

No User Pays charges applicable.

### c) Proposed charge(s) for application of Users Pays charges to Shippers

No User Pays charges applicable to Shippers.

### d) Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve

No charges applicable for inclusion in ACS.

## 3 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

***Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;***

Several respondents believed that implementation would encourage longer-term bookings of entry capacity by removing the price incentive to buy later and therefore be consistent with this objective.

However, SSE considered that longer term bookings would not be encouraged and implementation might even discourage use by producers of declining offshore fields leading to underutilisation of the system. For similar reasons EDFE considered that the effect of implementation would be neutral.

***Standard Special Condition A11.1 (b): so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of***

***(i) the combined pipe-line system, and/ or***

***(ii) the pipe-line system of one or more other relevant gas transporters;***

Implementation would not be expected to better facilitate this relevant objective.

***Standard Special Condition A11.1 (c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;***

Several respondents believed implementation would better facilitate the charging methodology objectives as set out in Standard Special Condition A5, including cost reflectivity, promoting efficiency and avoiding undue preference.

EDFE pointed out that the current licence wording required National Grid NTS to hold a clearing auction and implementation would be inconsistent with this. It also disagreed that cost reflectivity would be promoted as it considered that recent developments, such as substitution, increased the risks associated with reliance on short term capacity booking and therefore that the costs reflected this element of risk. It also pointed out that implementation might simply show a migration from WDDSEC to DADSEC and therefore the impact on TO revenue would be marginal.

***Standard Special Condition A11.1 (d): so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:***

***(i) between relevant shippers;***

***(ii) between relevant suppliers; and/or between DN operators (who have entered into transportation arrangements***

Several respondents believed implementation would reduce the large quantities of zero priced NTS Entry Capacity being released, therefore possibly encouraging Shippers to purchase longer term capacity and encourage further utilisation of the secondary capacity market. This proposal is part of a suite of proposals that are seeking to reduce the level of the TO Entry Commodity charge and hence seeking to avoid potential cross subsidies which may arise when this commodity charge represents a significant proportion of TO entry revenue. Removing potential cross subsidies is consistent with this objective.

A number of respondents not supporting implementation considered that current issues, that implementation was attempting to correct, were characteristic of using auctions as the primary methods of booking capacity.

Some respondents also considered that implementation would produce greater certainty with respect to charging.

However, E.ON, SSE, EDFE and EDFT considered that implementation might only benefit a certain type of Shipper and others types would be adversely affected by implementation. They cited the lack of analysis carried out to demonstrate the effect of implementation on various classes of Shippers Examples given were of adversely affected Shippers were those with a diverse portfolio and those seeking to take gas from marginal or declining offshore fields. EDFE and EDFT also considered that implementation would adversely affect prompt liquidity and increase NBP volatility.

***Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards… are satisfied as respects the availability of gas to their domestic customers;***

Implementation would not be expected to better facilitate this relevant objective.

***Standard Special Condition A11.1 (f): so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;***

Implementation would not be expected to better facilitate this relevant objective.

## 4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

National Grid NTS believes this proposal would benefit operation of the Total System with the GB as an attractive destination for gas through increased regulatory and charging certainty. Some of those supporting implementation also considered that a greater degree of pricing certainty would enhance security of supply. However some of those not supporting implementation considered that implementation would adversely affect the maintenance of declining offshore fields and thus adversely affect security of supply.

**5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:**

**a) Implications for operation of the System:**

National Grid NTS believes that the operation of the system would not be adversely affected. This Proposal could prove beneficial to the operation of the system as more capacity could be booked long term thereby creating greater certainty.

**b) Development and capital cost and operating cost implications:**

No cost implications have been identified

**c) Extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:**

Not applicable.

**d) Analysis of the consequences (if any) this proposal would have on price regulation:**

No such consequences have been identified.

**6 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal**

No such consequences have been identified.

**7 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users**

No changes to UK Link, NTS systems or User systems have been identified.

**8 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk**

***Administrative and operational implications (including impact upon manual processes and procedures)***

National Grid NTS believes there are minor administrative or operational implications.

***Development and capital cost and operating cost implications***

National Grid NTS believes there are no development, capital or operating cost implications.

***Consequence for the level of contractual risk of Users***

EDFE considered that implementation would adversely affect Users contractual risks as investment decisions will have been taken based on the existing entry capacity products and charging methodologies.

**9 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party**

No consequences for other relevant persons have been identified.

**10 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal**

A number of respondents not supporting implementation considered that implementation might need to be reversed due to incompatibility with expected changes in European regulations.

**11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal**

**Advantages**

National Grid NTS believes that the benefits of this proposal are that the Proposal:

- Should increase the proportion of NTS TO target entry revenue recovered through entry capacity charges. The forward looking analysis suggests that, with the proposed reduction of quantities of Daily NTS Interruptible Capacity made available combined with the removal of firm Daily NTS Entry Capacity reserve price discounts, entry capacity revenue will increase as more firm capacity is procured other than at a zero price. This is a necessary first step en route to achieving the maximum proportion of NTS TO target entry revenue which can be recovered through entry capacity charges.
- Provides a more apt redistribution of charges. The TO Entry Commodity Charge was designed as a correction mechanism for under recovery of allowed revenue from auctions. Using this charge to collect a large amount of under-recovered income from entry capacity auctions may currently result in a redistribution of charges from Users, acquiring Entry Capacity at a discounted rate, to those Users that have previously paid a "full" rate for capacity.
- Promotes secondary trading. The availability of capacity with zero reserve prices may be a factor that inhibits entry capacity trading at ASEPs when there is unsold Obligated NTS Entry capacity. Some Users may have surplus capacity holdings and others are seeking short-term rights but the value of sold capacity is minimised by the existence of zero priced capacity. Removal of discounts should promote the secondary market in entry capacity.

- Could prevent cross subsidies between Shippers who buy NTS Entry Capacity (short term) rather than firm (long term). Shippers have an incentive to purchase Daily NTS Entry Capacity rather than QSEC or AMSEC. This could mean that short-term capacity buyers are having their costs paid by Shippers who have previously paid the longer-term rate for capacity creating cross subsidies between Shippers who buy firm rather than interruptible.
- Should increase the proportion of revenue recovered through capacity, as opposed to commodity, charges through increasing the incentive to make longer-term bookings (e.g. QSEC), which might improve price certainty.
- When capacity becomes constrained at an entry point, where previously there was a perception of surplus capacity, and where long-term signals for incremental capacity investment have not been received from QSEC auctions, high and volatile prices and more frequent scale back of Interruptible NTS Entry Capacity may be observed until Incremental NTS Entry Capacity is signalled and provided.

**Disadvantages**

- Users would see a decrease in the quantities available at zero reserve price and this may be viewed as limiting their ability to access entry capacity; however, the UIOLI interruptible quantities would continue to be released at zero price when firm capacity was close to selling out.
- Removal of discounts will not necessarily remove the shortfall between TO target entry revenue and TO entry capacity revenue (depending on shipper booking behaviour); however, it is a necessary step prior to further options being developed, as required, including price multipliers and/or further changes to products.

## 12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Representations were received from the following:

| Organisation | | Position |
|---|---|---|
| BG Gas Services Ltd | (BG) | Support |
| British Gas Trading Limited | (BGT) | Support |
| E.ON UK plc | (E.ON) | Not in Support |
| EDF Energy plc | (EDFE) | Not in Support |
| EDF Trading Markets Limited | (EDFT) | Not in Support |
| ExxonMobil Exploration UK Limited, ExxonMobil Exploration and Production Norway AS, and ExxonMobil Gas Marketing Europe Limited | (EM) | Support |
| National Grid NTS | (NGNTS) | Support |
| RWE Npower plc, and RWE Supply and Trading GmbH | (RWE) | Support |
| Scottish and Southern Energy plc | (SSE) | Not in Support |

| | | |
|---|---|---|
| Scottish Power | (SP) | Support |
| Statoil (UK) Limited | (STUK) | Support |
| Total E&P UK Limited | (TEP) | Support |

Thus eight responses supported implementation and four did not support implementation.

**13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation**

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

**14 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence**

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence.

**15 Programme for works required as a consequence of implementing the Modification Proposal**

No programme for works would be required as a consequence of implementing the Modification Proposal.

**16 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)**

The Proposer has suggested an implementation date of 01 October 2010.

**17 Implications of implementing this Modification Proposal upon existing Code Standards of Service**

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

**18 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel**

**19 Transporter's Proposal**

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity Markets Authority in accordance with this report.

**20 Text**

**UNIFORM NETWORK CODE**

**TRANSPORTATION PRINCIPAL DOCUMENT**

**SECTION B – SYSTEM USE AND CAPACITY**

*Amend paragraph 2.4.13(f) to read as follows:*

"(f) the "**reserve price**" shall mean~~:~~

~~(i)~~ in respect of Daily NTS Entry Capacity applied for and allocated prior to or after 06:00 hours on the Day for which it was applied for, the reserve price for Unsold NTS Entry Capacity (in accordance with National Grid NTS's Transportation Statement). ~~; or~~

~~(ii) in respect of Daily NTS Entry Capacity applied for and allocated after 06:00 hours on the Day for which it was applied for, zero.~~"

For and on behalf of the Relevant Gas Transporters:

**Tim Davis**
**Chief Executive, Joint Office of Gas Transporters**