

URGENT Modification Report
Allocation of Incremental System Entry Capacity at System Entry Points with Descending Price
Schedules
Modification Reference Number 0744
Version 2.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because in respect of the recent Milford Haven auction the quantity of Permanent Obligated Entry Capacity will remain unchanged; however the quantity to be allocated to Users will be different if this Proposal is not approved. The affected Users have been informed that the allocations made for April - September in each of 2017-2020 (inclusive) are provisional and cannot be relied upon; they may be modified following the decision made with regard to this Modification Proposal. Urgent status would therefore reduce the period of uncertainty for those Users who have bid in the recent Entry Capacity auctions and who may have to delay other business decisions that are dependent upon the auction allocations. This situation may be particularly important to resolve in a short timescale as the ASEP affected is a New ASEP.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Agreed Timetable:

Proposal issued to Ofgem for decision on urgency	10/02/2005
Proposal agreed as urgent	11/02/2005
Circulate to Users requesting representations	11/02/2005
Representation close-out	17/02/2005
Urgent Modification Report issued to Ofgem	23/02/2005
Ofgem decision expected	25/02/2005

1. The Modification Proposal

Modification Proposal 0667 “Allocation of Incremental System Entry Capacity at System Entry Points with Descending Price Schedules” was raised to enable capacity allocation to be maximized in instances where Users bids are placed against a descending price schedule. The Proposal was described as follows:

“The Network Code sets out the rules for the allocation of Quarterly System Entry Capacity (QSEC) at Aggregate System Entry Points (ASEPs) made available for sale in the annual invitations for System Entry Capacity. In such invitations capacity amounts are offered for sale as incremental amounts at pre-determined prices. The amounts offered and the relevant prices, the step prices, are specified in accordance with Transco’s GT Licence and Transco’s Transportation Statement.

ASEPs can have ascending price schedules i.e. where step prices increase as the corresponding incremental amounts of QSEC offered increase or descending price schedules i.e. the step prices decrease as the corresponding amounts of QSEC offered increase.

The existing Network Code rules (B2.6) establish that when considering incremental quantities specified in the annual invitation in ascending price order the amount of capacity allocated is at the step price, “the relevant step price group” where the amount of capacity demanded is first equal to or less than that available. This rule has worked successfully for ascending price auctions, however the provisions of B2.6.5 would not facilitate a consistent allocation of capacity at an ASEP where there were a descending price schedule. Potentially, application of the present rules to descending price auctions could indicate that an inappropriately low volume should be released. Transco believes that the clause should tend towards maximizing capacity allocations such that for the purposes of capacity allocation the relevant step price group is where the amount of capacity demanded is **last equal to or less than** that available. Transco believes that the Network Code therefore needs to be amended to include this provision.”

This Modification Proposal is intended to clarify the treatment of bids in descending price auctions and better align the Network Code with the intent of Modification Proposal 0667, which we believe would also make it consistent with the analytical model made available to inform Users of how the allocation process would be applied.

In order to better achieve the objective of tending to maximize capacity allocation it is proposed that the Network Code should be modified such that, in instances of a descending price auction, the quantities on offer should be considered in descending price order with the highest priced first (step price one) rather than in ascending incremental volume order. The price stack should also include the reserve price.

Once capacity release has been set at a given level, the final allocation would then be assessed with this volume availability and in effect the price schedule reorganized such that the zero priced quantity (reserve price) is placed at the end of a sequence of descending prices (i.e. cheapest last).

Transco believes that this Modification Proposal would enable allocations to be maximized in instances where a descending price schedule is published and Users may have placed large volume bids at the reserve price. Release of Entry Capacity would continue to be predicated on satisfaction of the relevant tests as set out in Transco’s Incremental Entry Capacity Release Statement.

2. Transco’s Opinion

Transco, as proposer, supports implementation of the modification proposal .

Transco believes that capacity should be allocated consistently with the other relevant provisions of the Network Code and the Incremental Entry Capacity Release statement (IECR). Under the present Network Code rules it is not clear that an appropriate volume of capacity would be released at ASEPs with descending price schedules. This situation could be overcome by both considering the quantities on offer in descending price order with the highest priced first (step price one) rather than in ascending

incremental volume order, and with the reserve price included in the price stack.. These changes would better achieve the objective of increasing competition by tending to maximize capacity allocation. The proposal would also make it consistent with the analytical model made available to inform Users of how the capacity release and allocation process would be applied.

The proposal would enable Transco to discharge its primary duty as a Gas Transporter as specified in its GT licence such that it operates its pipeline system in an economical and efficient manner.

3. Extent to which the proposed modification would better facilitate the relevant objectives

Transco believes that implementation of the modification proposal would better facilitate Transco's relevant objectives particularly in terms of the economic and efficient operation of its pipeline system. Where capacity is to be offered for sale at an ASEP with a descending price schedule the proposed modification will facilitate the appropriate market signals thus enabling economic investment decisions to be made and would ensure maximum allocation of capacity at the lowest price, consistent with the operation of the system in an economic and efficient operation

The modification proposal should facilitate competition between shippers as capacity allocation would be maximized.

The proposal takes account of developments in the transportation system in facilitating the efficient development of capacity at an entry point with a descending price schedule.

4. The implications for Transco of implementing the Modification Proposal , including **a) implications for the operation of the System:**

There are no implications for the physical operation of the System.

b) development and capital cost and operating cost implications:

No additional operating costs or capital costs are envisaged.

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

Not applicable

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

Transco believes that there are no direct consequences on the structure of Transco's SO incentives either prior to or following implementation of the proposal. The determination of quantities of permanent obligated incremental entry capacity would remain unchanged.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

There are no such consequences.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

No development implications for Transco's computer systems or those of Users would be required as a result of implementation.

7. The implications of implementing the Modification Proposal for Users

Transco is not aware of any implications for Users.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

Transco is not aware of any such implications.

9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

Transco anticipates no such consequences.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages :

The proposal should enable Transco to make investment decisions in response to the market signals received in the annual invitations for system entry capacity

The proposal should enable capacity allocation to proceed in a manner that is consistent with the incremental quantities identified by Transco's model in support of its Incremental Entry Capacity Release statement.

Disadvantages :

Transco is not aware of any disadvantages to the proposal.

11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Representations have been received from the following :

BG Gas Services	(BG)
EON (UK)	(EON)
ExxonMobil	(EXM)
Statoil (UK)	(STUK)
Total Gas & Power	(TGP)

Of these, four respondents express support for the modification proposal, with one respondent (STUK) expressing no overriding view.

Of those in support of the proposal, recognition is given to the fact that implementation would reflect the intent of Modification Proposal 0667 and maximise capacity allocation in instances of a descending price schedule, thus resulting in a more efficient release of capacity.

BG suggests that restricting long term capacity releases to a level below capacity availability potentially creates a number of inefficiencies, such as shippers not being able to contract long term for their entry capacity needs and capacity prices being driven inefficiently high. This could result in Transco not receiving signals to invest in capacity at the appropriate efficient level and investing in capacity at a sub-optimal level

BG also comments that this modification is consistent with Modification 0667, general industry understanding of how the capacity regime “should” work and with the analytical model developed by Transco and made available to assist those bidding in the auction for System Entry Capacity at Milford Haven in December 2004.

STUK expresses concern that Transco may be changing the Network Code in order to bring it into line with its model, rather than apply the rule as set out in the Network Code and the IECR. Both these sets of rules were available prior to the start of the auction and it must be assumed that the model was available prior to the start of the auction to test for possible outcomes. It further argues that given the bidding at the terminal would have taken place under one set of assumptions participants may have reacted differently if the auction had been conducted under a different set of rules.

STUK also asks whether there would be a need to change the IECR to reflect the structure of the model.

Transco response

Transco welcomes the support from the respondents for the proposed modification.

In particular Transco welcomes the comments from the respondents that expressed the view that the proposal addresses the need to maximize capacity availability and allows efficient allocation of capacity at ASEPs with descending price schedules and that the proposal should allow Transco to better fulfill its duty to operate its pipeline system in an economic and efficient manner.

Transco acknowledges that the proposal would change Network Code to bring it into line with the IECR model, but that such a change would be necessary to be consistent with the intent of Modification Proposal

0667. This would ensure allocation of capacity is maximised at the lowest price, thus furthering the efficient and economic operation of the system. Transco does not believe that the change, had it been introduced prior to the auction, would have influenced Users bidding strategies as, in Transco's view, it is likely that these were developed in accordance with the intent of Modification 0667 and the IECR model. The proposal seeks to align Network Code with the IECR model and the intent of Modification 0667.

Transco can confirm that no changes to the IECR statement would be required as this outlines the criteria needed for the release of incremental entry capacity rather than any detailed description of the allocation process itself (which is detailed within Section B of the Network Code).

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation

Implementation is not required for this purpose.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Implementation is not required with regard to any such proposed change.

14. Programme of works required as a consequence of implementing the Modification Proposal

No programme of works is required.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

Representation close-out	17/02/2005
Urgent Modification Report issued to Ofgem	23/02/2005
Ofgem decision expected	25/02/2005
Proposed Implementation Date	25/02/2005

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of the proposal.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

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

19. Text

Section B

Amend paragraph 2.2.10 to read as follows:

“2.2.10 Where in relation to the incremental amounts of Quarterly System Entry Capacity specified in an annual invitation the step prices specified:

- (a);
- (b) decrease as the incremental amount itself increases, Users may only submit a second or further Quarterly capacity bid where the ~~step~~ price applied for is less than that applying to any other bid, if the amount of Quarterly System Entry Capacity applied for in such bid is no less than that applied for under any earlier bid.”

Amend paragraph 2.2.11 to read as follows:

“2.2.11 Transco shall reject a capacity bid submitted on an annual invitation date where:

- ~~(a) — the bid price is less than the reserve price or is not a step price;~~
 - ~~(a)~~ (b) the requirement in paragraph 2.2.10 is not complied with;
 - ~~(b)~~ (c) any ~~other~~ requirement of paragraphs 2.2.6 or 2.2.7 is not complied with,
- and Transco may reject a capacity bid in accordance with Section V3.”

Amend paragraph 2.6.5(b)(iii) to read as follows:

“(iii) where paragraph (i) above is not applicable and paragraph 2.2.10(b) applies, the step price group or those bids at the reserve price (as the case may be), when considering the incremental quantities step prices and the reserve price specified in the annual invitation in ascending descending order, in respect of which the step price group quantity or the Reserve Price Bid Amount is last equal to or less than the Actual Available System Entry Capacity.”

Signed for and on behalf of Transco.

Signature:

R.Court
Commercial Frameworks Manager
NT & T

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0744**, version **2.0** dated **23/02/2005**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **2.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.