

Modification Report
Allocation of Incremental System Entry Capacity at System Entry Points with Descending
Price Schedules
Modification Reference Number 0667
Version 1.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

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.

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 an inappropriate volume of capacity could be released at ASEPs with descending price schedules. This outcome could occur because application of the existing rules could require Transco to release a lower quantity than may have been demanded by Users at other price steps. 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.

The amendment has not had any material consequences to date because in the two annual invitations for QSEC to date capacity has only been offered for sale at ASEPs with ascending price schedules. However, this does not preclude that capacity may be offered at an ASEP with a descending price schedule at any time in the future and therefore it is timely that the amendment is proposed.

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

Transco believes that implementation of the modification proposal better facilitates 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 therefore economic and efficient operation. In the absence of the proposed modification there would be an increased possibility that Transco would not be able to act upon the appropriate market signals resulting ultimately in increased cost to Users and restricted access to Entry Capacity.

The modification proposal could be seen to facilitate competition between shippers in that capacity availability would be maximized and would be made available economically and efficiently thereby lowering any barriers to entry that would otherwise exist.

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. To date capacity has only been offered for sale at ASEPs with ascending price schedules.

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 are envisaged, whilst additional capital cost can be expected if the capacity allocation reflects a tendency to optimize capacity allocation, which is the intention of this proposal. Additional capital costs would normally be reflected by increased Entry Capacity Investment incentive income.

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:

Costs will be recovered through Transco's SO incentive.

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. However, Transco does acknowledge that without implementation of the proposal there could be potential distortion of the investment signals that Transco may receive and/or on the revenues collected or costs incurred.

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

Some systems development will be required to enable Entry Capacity to be released on the basis proposed. No further implications are anticipated for the related computer systems of Users.

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 believes that the modification proposal is consistent with its licence arrangements to operate its pipeline system in an economic, efficient and coordinated manner.

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 be optimized in a manner that is consistent with the incremental quantities identified by Transco's Incremental Entry Capacity Release statement.

Disadvantages:

Transco has not been made aware of any disadvantages

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:

British Gas Trading (BGT)
EDF Energy (EDFE)
ExxonMobil (EXM)
RWE Innogy (INN)
Powergen (PGEN)
Scottish and Southern Energy (SSE)

All six respondents supported implementation of the modification proposal.

BGT state that the modification proposal puts into practice the recognition that the unit rate of an additional unit of capacity at a given entry point is not always incremental and that economies of scale will mean that additional volumes of capacity availability will result in a lower unit rate at some stage of the proposed re-enforcement. Also that this is particularly relevant at new entry points where continued adherence to the principle of incremental unit rate would have resulted in very low volumes of capacity being provided at high unit rates, which in turn could have placed a significant disincentive to potential Users of the facility. BGT believe that this principle should extend to any entry point where there is a demonstrated need for enhancement at a significant scale in order to reflect the true cost of the reinforcement in the unit rates.

BGT also state that without the modification proposal there could be consequences on price regulation and the modification report should reflect this. BGT also express some concern that the legal text supplied does not correctly deliver the intent of the proposal but does not elaborate any further on the matter.

EDFE supports the proposal as it believes that price schedules should be allowed to both increase and decrease and that the proposal will maximize capacity allocations for each step price group.

EXM states that the proposal should allow all volumes bid in successive (descending price) step price groups to be taken into account in establishing the most economic and efficient investment. Otherwise, under the current scheme, it is possible that shippers who bid capacity at higher price steps (corresponding to lower unit prices in a descending price schedule) may not have their volumes considered. EXM also state that whilst it is not clear that the proposal deals with all the changes required to allow efficient auctions and/or investment for bids placed on descending price schedules, it does nevertheless represent a clear improvement over existing arrangements.

INN states its support for the modification proposal.

PGEN states it is in favour of the proposal and that the proposal represents a pragmatic approach to maximize capacity available for sale at an ASEP.

SSE supports the modification proposal and believes it is essential to ensure the maximum level of capacity is made available where there are descending price schedules and to ensure appropriate investment signals are given to Transco to facilitate economic and efficient operation of the system. If the proposal is not implemented this would result in inefficient allocation of capacity and could have implications for competition. SSE also states its hope that the proposed timescales for implementation of the modification proposal can be met.

Transco response

Transco welcomes the support of all the respondents for the proposed modification.

In particular Transco welcomes the comments from the respondents that expressed the view 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 the point that without implementation of the modification proposal there could have been a distortion of costs and revenues and perhaps there could be a disincentive to potential Users of the facility. However Transco believes that there may not have been a direct impact on price regulation per se i.e. on the structure of the SO incentives but there could have been an effect on the amounts of revenue collected and costs incurred and on a potential distortion of investment signals. Nevertheless the modification report has been amended to reflect this.

Transco notes the views of the respondent that stated that they are not clear that the proposal deals with all the changes required to allow efficient auctions and/or investment for bids placed on descending price schedules, but without further detail Transco cannot make a specific comment other than to state that it believes that the proposal does meet the requirements for Transco to maintain and operate an economic and efficient pipeline system. Similarly, Transco notes the views of the respondent in relation to the legal text as there is no specific detail on which to comment Transco can only re-iterate that it believes that the legal text does reflect the requirements of the proposal.

Transco also supports the request that the proposed timescales for implementation of proposal can be met.

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 having regard to any such proposed change.

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

There would not be a significant programme of works.

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

Circulate to Users requesting representations	01/12/03
Representations close out	15/12/03
Final Modification Report to Ofgem	19/12/03
Ofgem decision expected	31/12/03
Implementation date	05/01/04

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of this 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 2.6.4(b) to read as follows:

“(b) where paragraph 2.2.10(b) applies. . . is equal to the Actual Available System Entry Capacity, . . .”

Amend paragraph 2.6.5(b) to read as follows:

“(b) the “**relevant step price group**” is:

(i) where paragraph 2.2.10(a) applies, the step price group . . . is first equal to or less than the Actual Available System Entry Capacity; and

(ii) where paragraph 2.2.10(b) applies, the step price group, when considering the incremental quantities specified in the annual invitation in ascending order, in respect of which the step price group quantity is last equal to or less than the Actual Available System Entry Capacity;

Signed for and on behalf of Transco.

Signature:

Mike Calviou
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 **0667**, version **1.0** dated **17/12/2003**) 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 **1.0**.

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.