

Modification Report
Modification to LTSEC Weak Closure Rule
Modification Reference Number 0623
Version 3.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

This Proposal includes three elements:

- the refinement of the definition of prevailing relevant step price group so that it includes the step price level at which aggregate demand is first less than or equal to notional supply at that step price level. A change of this nature would be in accordance with the interpretation that a number of Users had previously placed upon the Network Code text.
- a renaming of the “prevailing step price group” to “Stability Group” to address the concern, as perceived by the NT&T Workstream, that the relevant step price group is less likely to be construed as signalling the final price to be paid by Users who are successful in the Long Term System Entry Capacity; and.
- the introduction of a stronger closure rule which might be expected to encourage Users to bid throughout the process and therefore should tend to improve the efficiency of the auction process. The NT&T Workstream considered, and this Proposal envisages, that it would be appropriate to consider changing the closure rule to require that the LTSEC auction will close if the "Stability Group" changes in fewer than five individual instances (quarters/ASEP combinations) when compared with the level of "Stability Group" associated with the previous auction round. In this case each instance refers to the "Stability Group" reported in every quarterly period at every entry point (approximately 900 instances) at which Entry Capacity is made available. This would differ from the present arrangements to the extent that at present any changes in any quarter at any ASEP will ensure the requirement for another auction round (except for the 10th round).

2. Transco's Opinion

Transco believes that it is appropriate to respond to User concerns that improved clarity in the Network Code rules that are applicable to the auction of Long Term System Entry Capacity and a strengthening of the closure rules might improve the efficiency of the auction process thereby better facilitating competition between Users.

Strengthening the weak closure rule is intended to enhance the efficiency of the auction process where the most efficient outcome might be expected if Users are

encouraged to bid throughout the process because otherwise they face a risk that the process might terminate before they have indicated their capacity requirements.

Following consultation Transco can confirm that the balance of argument, in its opinion, supports implementation of a strengthened closure rule.

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

Transco considers that shipper to shipper competition would be better facilitated by employing Network Code rules that provide a high level of clarity for all Users. Greater clarity and a strengthening of the closure rule would, in the opinion of Transco, tend to facilitate a more efficient auction process which might be expected to better facilitate competition between Users.

4. The implications for Transco of implementing the Modification Proposal , including

a) implications for the operation of the System:

Transco has not identified any implications for the operation of the System.

b) development and capital cost and operating cost implications:

No significant development and capital cost and operating cost implications are envisaged. Development of IT systems and processes to support a strengthened closure rule would be conducted as a part of the Gemini development.

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 envisages no such consequences.

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

Transco envisages no such implications.

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

Transco envisages no such implications and respondents to this consultation have not identified any implications for related computer systems for Users.

7. The implications of implementing the Modification Proposal for Users

Users would participate in LTSEC auctions in accordance with the present bidding arrangements.

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

No such implications are anticipated.

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

No such consequences are anticipated.

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

Advantages :

- Greater clarity afforded to Users about application of the process.
- Stronger incentives to bid accurate requirements early in the auction process.

Disadvantages :

- Introduces possible uncertainty about how strengthened gate closure rules impinge upon bidding strategies.
- A stronger gate closure rule would tend to reduce the opportunities for revising bids.

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

Eleven representations have been received. The respondents were:

Entergy Koch (EK)

Scottish and Southern Energy (SSE)

Innogy (I)

ConocoPhillips (C)

British Gas Trading (BGT)

Chevron (CH)

Statoil (STA)
Scottish Power (SP)
TotalFinaElf (TFE)
Shell Gas Direct (SGD)
ExxonMobil (EM)

Refinement of the Definition of prevailing relevant step price group

All respondents supported this aspect of the proposal which is to modify the definition of prevailing relevant step price group. The majority of comments welcomed attempts to provide a clear definition and a number observed that this should reduce confusion.

Transco comment

Transco welcomes support for this aspect of the proposal and agrees with respondents that providing clear definitions in the Network Code is desirable.

Renaming of the "prevailing step price group" to "Stability Group"

Nine respondents expressly supported this aspect of the proposal (EM, SGD, TFE, SP, STA, BGT, C, SSE, EK) and no objections were raised. BGT offered a view that the change was largely semantic. Chevron commented that it did not find the present definition confusing but could "live with" the proposed change. SGD supported the proposal on the basis that it would "remove any misunderstanding that there may have been amongst participants as to what this *price* did and did not represent".

Transco comment

Transco welcome support for the name change which should serve to provide further clarity about the purpose of the closure rule.

Introduction of a stronger closure rule

Six respondents supported proposals to introduce a stronger closure rule (EK, I, C, CH, SP, SGD) whilst five opposed (SSE, BGT, STA, TFE, EM). EK argued that the proposal would reduce the risk of last round games and should improve the quality of market signals. EK also argued that it would be of benefit to Users who will free up resources if the auction closes early. EK concluded that this "minimal change to the existing arrangements is the best way forward. EK argued that four periods or less may still leave the auction relatively easy to game, but that increasing the number of periods is unnecessary at this stage, as the whole industry is still learning how to deal with long term auctions."

Innogy (I) agreed that a "modest tightening" did not appear to be overly restrictive and it offered an opinion that it is difficult to judge whether the reduced flexibility for Users to revise bids that is implied by the proposal would distort the allocation process. Innogy concluded that efficiency will be improved if the proposal encourages Users to bid early on the expectation that the auction could close before they have bid their capacity requirements.

One respondent (C) offered an opinion that the previous LTSEC auction may have been artificially kept "open" and that the proposal may not necessarily deter this behaviour but that it is a step in the right direction.

Sp noted that it has been argued that the reduction in opportunities for revising bids can be seen as a disadvantage of introducing the stronger closure rule, but it considers that the advantage of this would be to make bidding more timely and accurate. As a consequence Sp would expect to see a reduction in the number of auction rounds and earlier price discovery.

SGD supports the proposed move to a stronger closure rule. It notes that this is still referred to as a weak closure rule and it does not consider that the proposal will encumber the process with too strict a closure rule that could undermine the auction process. SGD considers that fewer than five changes is a reasonable figure and it believes that this further step is required to ensure that Users are encouraged to bid throughout the process, leading to a more efficient process and, potentially, earlier closure. SGD agrees that the proposal would further the relevant objectives by improving shipper to shipper competition through better understanding of the auction process and by facilitating a more efficient auction process.

Ch indicated that it was less convinced about the proposed change in closure criteria to a maximum of four quarters/terminals but, never the less, commented that it could "live with" the suggestion.

SSE expressed concern that the proposal to introduce a stronger closure rule is premature and could result in further change and uncertainty. SSE believes that further information is required in order to understand whether and why Users tried to keep the auction open and withheld bids to later rounds. SSE argued that the potential impact of the proposal should be understood before it is implemented and offered a view that the results of more than one auction would be required before meaningful analysis could be completed.

BGT expressed concern that the process could still be susceptible to manipulation and it believes that the Shipper licence requirement "not to give misleading information to the Transporter" should provide reassurance. BGT observed that it would fall to Transco to identify such conduct were this to be apparent and for the Regulator to take action as necessary.

Sta has concerns about strengthening the closure rule because the combined impact of all the changes highlighted in this proposal may make the closure mechanism too difficult to predict. Sta considers that the clarification of the Stability Group may provide greater stability to the closure mechanism without increasing the early closure rule. Sta observed that this aspect of the proposal cannot be implemented until after the next auction and therefore concluded that it may be more appropriate to consult on this change separately when Users will be able to contribute experiences from a further annual auction.

TFE also argued against introducing too many changes to the process at any one time. TFE is not aware of any research that has been done to determine that five is the appropriate number and observed that four quarter/ASEPs is likely to be a significant proportion of the instances in which there is in practice potential movement in the "Stability Group". TFE does not want the auction to close

before Users have had an opportunity to properly explore the impact of any variability in their demand upon total industry demand.

Em considered that it was not clear that the proposal would offer a strong enough incentive to bid accurate requirements early on in the auction. Given that this change would not be available in time for the next auction Em believes that more time should be allowed to evaluate more fully the relative merits of this proposal alongside other potential solutions.

Transco comments

Transco welcomes support for strengthening the closure rule and agrees with those respondents who argue that a beneficial outcome of the proposal is that it should encourage Users to bid their "true" requirements early in the process. Transco believes that in order to achieve this outcome a level of uncertainty is required about precisely when early gate closure might be invoked.

Transco notes BGT's observation that the shipper licence requires that misleading information should not be passed to the Transporter, however Transco believes that the licence provision does not detract from the benefit that can be gained from Network Code changes that could further improve the auction process.

It is not clear to Transco what type of analysis could be conducted prior to implementation that would enable a "correct" stability threshold to be calculated. It appears from the responses that there is wide spread acceptance that it is desirable to encourage accurate bidding and that the process could be aided by strengthening the closure rule. Transco agrees with those respondents who consider that four ASEP/quarters would be a pragmatic first step. It is not clear that further steps will be required, but if that should prove to be the case then Transco would be willing to review the threshold. A number of respondents alluded to the possibility of analysing the extent of gaming during the previous auction. Transco considers it is very difficult to conceive of how such analysis could be conducted. We would be pleased to hear of any suggestions about how Transco could carry out this type of monitoring.

It has also been argued that this proposal, in total, presents too great a level of change. Transco is of the opinion that clarification of the rules and changing the naming convention will have a minor but beneficial effect encouraging Users to bid early in the process. Both of the changes will, if approved, apply to the next LTSEC auction process. Strengthening the stability measure will, in Transco's opinion, also present a beneficial change that will encourage earlier participation in the auctions to the benefit of all Users. Transco therefore recommends implementation of the proposal.

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

No such requirement exists in respect of the Modification Proposal.

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

No such requirement exists in respect of the Modification Proposal.

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

A programme of works has been identified to strengthen the closure rule. It is anticipated that the work would be rolled into the existing Gemini development.

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

Clarification of auction rules could be introduced following any direction to implement the Proposal. A suggested implementation date for the proposal is 1 August.

Development of a strengthened closure rule would necessitate an implementation date of 1 November for that part of the Proposal. In order to present a consistent implementation date, the strengthened closure rule would be subject to a Network Code Transition document rule that would enable implementation on 1 August but require the strengthened closure rule not to take effect until 1 November.

16. Recommendation concerning the implementation of the Modification Proposal

Transco supports 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: SYSTEM USE AND CAPACITY

Amend paragraph 2.2.17 to read as follows:

2.2.17 Following the submission of quarterly capacity bids on each annual invitation date in the annual invitation period Transco shall as soon as reasonably practicable after 17:00 hours on each such date calculate and notify Users, in respect of each calendar quarter and each Aggregate System Entry Point, of the ~~provisional~~ Stability ~~step-price~~ Group by reference to identifying where the quantities of Quarterly System Entry Capacity applied for in aggregate by Users are first equal to or less than the incremental quantities specified in the annual invitation in ascending order. ~~up until~~ such time and on the basis of a provisional allocation of capacity in accordance with paragraph 2.6, exclusive of capacity to be made available pursuant to the Incremental Entry Capacity Release Statement.

Add new paragraph 2.2.18 to read as follows:

2.2.18 In the event that following calculation of the ~~provisional~~ Stability ~~step-price~~ Group (in accordance with paragraph 2.2.17) for each calendar quarter and each Aggregate System Entry Point following submission of quarterly capacity bids on the next following invitation date, the ~~provisional~~ Stability ~~step-price~~ Group remains unchanged in respect of all but four or fewer calendar quarters and Aggregate System Entry Point combinations:

- (a) Transco shall by not later than 08:00 hours on the next following annual invitation date, notify Users that this paragraph 2.2.18 applies and that the annual invitation period has ended; and
- (b) Users shall not be not be permitted to submit and Transco shall not be permitted to accept any further quarterly capacity bids in respect of the annual invitation.

Amend paragraph 2.6.5 to read as follows:

....

- (f) the "Stability Group" is 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 first equal to or less than the incremental quantities specified in the annual invitation in ascending order.

TRANSITIONAL DOCUMENT PART II

Insert paragraph 8.1.3 (A)

8.1.3(A) In respect of any annual invitation for Quarterly System Entry Capacity conducted prior to 1st November 2003 the requirement in paragraph B.2.2.18 shall be that the

Stability Group remains unchanged in respect of all calendar quarters and Aggregate System Entry Point combinations.

Signed for and on behalf of Transco.

Signature:

Nigel Sisman
Commercial 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 **0623**, version **3.0** dated **11/07/2003**) 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 **3.0**.

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.