

Modification Report
Short term six month auctions
Modification Reference Number 0625
Version 6.0

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 Proposer stated that :

"It is proposed that the AMSEC auctions are changed to being held every six months: in February for April to September entry capacity; and, in August for October to March entry capacity. To avoid overlap of auctions, LTSEC auctions will be held in September.

For the 2003/4 formula year, the timetable would then be as follows:

- | | |
|----------------|--|
| August 2003 | - MSEC for October 2003 to March 2004 (all baseline entry capacity) |
| | - AMSEC for October 2004 to September 2005 (unsold from January 2003 auctions) |
| September 2003 | - LTSEC for October 2005 to September 2017 |
| February 2004 | - MSEC for April 2004 to September 2004". |

2. Transco's Opinion

Transco recognises the Proposer's argument that holding MSEC auctions covering capacity periods of six months shortly before the start of such periods may enable auction participants to gain more up to date information in respect of the NTS maintenance schedule before their last opportunity to acquire MSEC entry capacity in either a summer (Apr - Sep) or winter (Oct - Mar) period. Additionally the Proposal affords the opportunity for entry capacity purchases in August for each month in the Gas Year starting in the October of the next calendar year. To avoid overlap of auctions, Transco notes the intent of the Proposal that LTSEC auctions would be held in September.

The proposal to offer April to September entry capacity in an auction to be held in February might, at first sight, appear to be similar to the now familiar experience since the start of RGTA that the first MSEC auctions for summer capacity are completed close to the start of the gas flow period. However, the summer capacity period (April (Y) to September (Y) where Y denotes Gas Year) would have already been offered in the AMSEC Auction conducted in August (Y-2). Furthermore, in an August AMSEC auction the Proposal would require that the succeeding six month period (October to March) should be offered and in addition 12 months of capacity from the following October, but not the intervening six month period from April to September. In Transco's view this could create uncertainty and complexity in the MSEC auction process. It is not

clear what benefit is obtained by not affording Users the opportunity to acquire entry capacity in the AMSEC auctions in August for the summer period of the next calendar year. This discontinuity could affect the perceived value of MSEC for the April to September period relative to other periods. Transco considers that Users might find it harder to manage their capacity positions given the 18 month gap between the two opportunities to acquire summer entry capacity in the auctions affected by this Proposal, should it be implemented.

On balance having considered carefully the views of respondents Transco considers that whilst the Proposal may afford some modest benefits these are likely to be more than offset by the additional complexity that would be introduced into the capacity release regime should the number of auctions relating to MSEC be further increased. Furthermore Transco considers that the proposed August auctions would cover a discontinuous period in which no summer capacity would be released. Therefore Transco concludes that implementation of the Proposal would not better facilitate the relevant objectives when compared with the current arrangements.

Notwithstanding the above Transco notes that this Proposal has interactions with other Proposals currently being considered, Modification Proposals 0616 and 0617.

In respect of Modification Proposal 0616, Transco recognises that this might be regarded as an alternate to this Proposal. Transco does not consider it would be appropriate to implement both unless a further proliferation of auctions were to be considered desirable. Transco notes that this has not been a consideration in the consultation and therefore cannot conclude that that was the Proposer's intent nor that such an outcome would better facilitate the relevant objectives. Therefore Transco concludes that should Modification Proposal 0616 be implemented then it would not be appropriate to implement this Proposal.

In respect of Modification Proposal 0617, Transco concludes that implementation of both that Proposal and this Proposal would not be feasible. Implementation of both would imply, for example, that the April 2005 to September 2005 period would first be released through the August 2003 auctions and then subsequently via the LTSEC auction in the next month. This would create the possibility for different quantities of entry capacity to be secured at any ASEP within any calendar quarter (the QSEC periods). This outcome would render the calculation of the quantities to be offered for sale in the LTSEC auctions impossible. Therefore Transco concludes that should Modification Proposal 0617 be implemented then it would not be possible to implement this Proposal.

Transco would therefore confirm that, when considered in the context of the relevant objectives, and against the current Network Code, that it does not support implementation of the Proposal.

Transco envisages no interaction with the operation of the electricity regime.

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

The Proposer does not state how implementation would better facilitate the relevant objectives.

Transco notes that auction participants might have access to better information about their own capacity requirements and Transco's maintenance plans ahead of the February MSEC auctions for summer capacity. However should this result in significant quantities of capacity not being sold well in advance of the summer capacity period it may detract from the efficiency of the capacity regime particularly in the context of the secondary capacity market and Transco's forward contracting activity for the management of buy-back risk. Transco concludes that though finely balanced the benefits may not offset the disadvantages associated with introducing a six month gap in the capacity period being offered. Therefore Transco concludes that this Proposal, if implemented, could impede the efficiency of the auctions thus acting to the detriment of 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:

Any increase in operating costs would be expected to be insignificant. Capital cost would be incurred for the development of the RGTA Capacity System.

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:

The costs would be covered by the internal costs incentive.

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

Some development work may be required to the RGTA Capacity System to accommodate the release of MSEC over two separate time periods.

7. The implications of implementing the Modification Proposal for Users

Users would participate in MSEC auctions held every six months rather than on an annual basis with the February MSEC auction covering a six month period and the August MSEC auction covering a discontinuous eighteen month period.

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 :

Participants in MSEC auctions would have access to more up to date information.

Users would have greater certainty in forecasting their capacity requirements.

Disadvantages :

Introduces increased complexity and uncertainty to the MSEC auction process.
Anticipated reduction in number of MSEC auctions is not delivered.

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

Representations were received from the following thirteen parties :

Chevron UK	(Ch)
Scottish & Southern Energy	(SSE)
Innogy	(Inn)
PowerGen UK	(PG)
ConocoPhillips UK	(CP)
London Electricity Group	(LE)
British Gas Trading	(BGT)
ENI UK	(ENI)
Statoil UK	(STUK)
Association of Electricity Producers	(AEP)
Scottish Power	(SP)

Total Fina Elf Gas & Power	(TFE)
Shell Gas Direct	(SGD)

Of these, six parties (SSE,PG,LE,STUK,TFE,SGD) expressed full support, one (Inn) gave conditional support, and six (Ch,CP,BGT,ENI,AEP,SP) did not support the Proposal.

General/ Six Monthly Auctions

Six respondents (PG,LE,STUK,TFE,SGD,Inn) stated that there would be benefits associated with a change to six monthly auctions, such as more up to date information being available that would help Users more accurately predict their capacity requirements, and giving Users greater flexibility. LE suggested that short-term auctions provided Users with an opportunity to buy entry capacity at prices which reflect known market conditions nearer the delivery date and Users would have a better view of what system demand levels would be. STUK commented that the Proposal provided an element of continuity with the previous short term auctions while also accommodating the new long term arrangements.

TFE acknowledged the huge amount of discussion within the industry over the timing of entry capacity auctions together with the length of the capacity period that they should cover. It suggested that the industry had never been fully comfortable with an annual auction for monthly capacity (MSEC). In addition, TFE stated, the clear focus of the discussions on Modification 0500 was the LTSEC process and as such, the decisions made on the shorter term processes possibly had not received quite as much attention as they merited.

In the context of better information, SGD commented that although Modification Proposals 0616 and 0617 were raised, in part, to reflect the better information available to shippers in February regarding Transco's maintenance plans, it had raised concerns that going to an April to March capacity year would mean that information available regarding future gas flows (e.g consumer contracts and NBP forwards trading) reflecting the Gas Year would be absent, undermining the efficiency of the auction process. SGD added that experience to date had demonstrated no inefficiency with having two "staggered" auctions over the Gas Year.

Two respondents (SSE,LE) commented that the six monthly cycle proposed appeared only to be transitional, with LE seeking clarification on this, and SSE stating that it would prefer all MSEC auctions to be held for six monthly blocks going forward.

Of those respondents opposing the Modification Proposal, Ch expressed support to the idea of holding AMSEC auctions in February, when information about NTS & offshore summer maintenance programmes should be available, a view that was shared by BGT. During the winter months, Ch added, little planned maintenance is carried out and forecasted flows, in aggregate at least, are more predictable. It further commented that it would be relatively simple to buy AMSEC in February of Gas Year Y for the period April (Y) to March (Y+1), whereas holding a single AMSEC auction during August (Y) for the period October (Y+1) to September (Y+1), in its view, would be more complex and

could lead to inefficient capacity capture. BGT added that the information just prior to the summer period was of greater value because of the greater volatility in the availability of system entry capacity. Ch and SP also commented on the increase in the number of auctions with Ch commenting that the increase would consume shipper time and resources without adding value.

Although expressing some support for six month auctions because of the timeliness of the information available, BGT argued that the industry had striven to move to a longer-term view and that to some extent the Transporter Licence now reflected this. In its view the conduct of an auction for twelve months capacity represented a reasonable compromise. BGT further suggested that the LTSEC allocation process followed by an annual MSEC auction and monthly RMSEC auctions represented the appropriate level of availability of entry capacity prior to offering a daily product.

CP suggested that there was a need for some stability and closure in the “current” regime, before more changes were introduced. In addition, it argued, prior to the next set of auctions shippers needed to be clear in what was being auctioned and for what period, and this modification would complicate both of these areas.

ENI stated preference for MSEC auctions to take place for the period October 2003 to September 2004. Whilst expressing agreement that shorter term auctions would allow Users to gain more up to date information for the period April to September 2004, it argued that the RMSEC auctions provided adequate opportunity for Users to fine tune their capacity requirements. It further suggested that not auctioning capacity for the intervening period from April to September would lead to confusion among Users, and expressed agreement with Transco's comments in the Draft Modification Report that the six month gap would create unnecessary complexity and uncertainty in the MSEC auction process, a view also expressed by SP. However, STUK stated that it did not feel that there would be any unnecessary confusion in offering Entry Capacity for the October of the following year. SGD noted Transco's comments that this would cause confusion but did not consider that this Proposal would make the regime unnecessarily complex.

Transco's response

Transco acknowledges that operating MSEC auctions on a six monthly basis has been a feature of the capacity regime that has been in operation since 1999 and has therefore become a familiar concept to Users. Transco would not wish to oppose a process that has worked reasonably satisfactorily for a number of years. Where it has concerns, however, is in the periods to be auctioned. In particular it is difficult to ascertain any benefit in not offering capacity in the summer period for Y+1 which the Proposer argues should be withheld despite offering capacity either side of that period. Such a feature could, in Transco's view, adversely impact on the efficiency of the MSEC auctions.

Interaction with Modifications 0616/0617

TFE & SP observed that there may be a need to do some "fine tuning" to the Modification depending on the decision taken on Modifications 0616 and 0617, with TFE stating that it did not see the latter issue as sufficiently complex to

discount the justification for this Modification, particularly as the decisions on 0616 and 0617 had not yet been made. SGD noted Transco's concerns regarding the interaction with Modifications 0616 and 0617 which would revise the standard year for entry capacity but commented that if those proposals were implemented that 6 month auctions would be even more important. If necessary, SGD added, a separate modification proposal could be raised if those modifications were approved.

Inn stated that there was clearly a timing issue between this Proposal and those Proposals that sought to introduce the concept of a Capacity Year aligned with the Price Control year, rather than the Gas Year. Inn added that it would prefer to retain the concept of Gas Year and that its support was conditional on the implementation issues associated with this Proposal and Modification Proposals 0616 and 0617 being resolved.

SSE questioned why Transco had concerns regarding interaction with Modification Proposals 0616 or 0617. Any move to six monthly auctions it argued should surely remove concerns regarding alignment between gas and formula year. SSE further questioned why the results of an August MSEC auction would need to be known before the September LTSEC auction and requested further clarification. PG suggested that any uncertainty created by other changes to the auction process, such as the possible implementation of Modification Proposals 0616 and 0617 were outweighed by the benefits of a shorter six-month timescale for the MSEC auctions.

Transco's response

Transco agrees that amendments would be needed to the Modification Proposal if a decision was made to implement Modification Proposal 0617, although unfortunately no process steps exist that would enable further development of this Proposal. Transco notes SGD's comment that a separate Modification Proposal could be raised if Modification Proposal 0617 was to be approved and believes that this would be an appropriate route. In respect of SSE's query on whether there would be any interactions between this Proposal and Modification Proposal 0616, Transco recognises that effectively Modification Proposal 0625 provides an alternate to Modification Proposal 0616; it would not seem to be appropriate to implement both unless a further proliferation of auctions is considered desirable. Transco notes that this has not been a consideration of the consultation and cannot conclude that that was the Proposer's intent.

The question raised by SSE regarding the results of the August MSEC auction again highlights that the auction timetable and discontinuous capacity period offered at the August MSEC auction, as proposed in this Modification, may not have been fully appreciated by some respondents. Transco can advise that if Modification Proposal 0617 were approved, the capacity period offered at the September 2003 LTSEC auction would be April 2005 to March 2017. However, Modification Proposal 0625 if implemented would offer capacity at the August 2003 MSEC auction for the period October 2004 to September 2005. Therefore, the MSEC for the six month period of April 2005 to September 2005 would be offered through the August 2003 MSEC auction prior to its release via the LTSEC auction in the following month. This would create the possibility that different quantities of entry capacity might be secured at any ASEP within any calendar quarter (the QSEC periods). This outcome would render the calculation

of the quantities to be offered for sale in the LTSEC auctions impossible. Transco therefore concludes that it would be inappropriate to implement this Proposal should Modification Proposal 0617 be implemented.

Also, the results of the August MSEC auction would not yet be known in time to determine the capacity availability figures for the LTSEC auction. In Transco's view, this emphasises the fact that although Modification Proposal 0625 has a clear intent in the context of current arrangements it would not "fit well" with implementation of Modification Proposals 0616/7, and could lead to confusion and complexity in the capacity periods on offer at the various LTSEC and MSEC auctions.

Effects on Transportation Charges

Two respondents (AEP,SP) expressed concern with any consequential changes to charges that might arise from holding auctions at six monthly intervals and whether the two month notice period for any changes to charges would be compromised. However, AEP added, if charges were to be set once a year, as considered in PD17 *Setting of NTS Transportation Charges* and if at least two months notice of any change were to be given then, it would be less concerned with when and how often auctions for entry capacity were to be held.

LE offered a contrary view on price volatility suggesting that the proposed process would introduce more stability into the Entry capacity auctions as prices for entry capacity would be less likely to change dramatically from one auction period to the next as there would be less uncertainty. It further suggested that more market reflected pricing would come out of short term auctions.

Transco's response

Transco agrees that the benefits of setting transportation charges once a year, as discussed in PD17 (Setting of NTS Transportation Charges) still apply, and maintains its view put forward during consultation on Modification 0616, that there would be a greater likelihood of avoiding mid-year price changes if MSEC is offered on an annual basis. The absence of an early sale of MSEC for the October - March period would increase the uncertainty of the price setting process. However, as stated as part of the consultation on Modification 0616, a reduction in notice period for changes to transportation charges from two months to one month would be required to introduce new charges from April 1st following an MSEC auction held in February.

Other Issues

Two respondents (STUK, Ch) expressed support for the moving of the Long Term auctions into September to avoid an overlap with the short term auctions and to avoid the July & August period.

BGT observed that as prescribed by the Transporter's licence, Transco now had an obligation to offer 100% of baseline capacity up to 548 days ahead. Therefore, in its view, implementation of the Modification Proposal would appear to create

certain unusual timings of the capacity to be offered if the comments provided by Transco in the Draft Modification Report were correct.

SGD commented that the 12 months of MSEC made available for the following October gas year would only be that held back while the two six months auctions would include the 20% held back. It added that if respondents felt that being able to bid for unsold capacity for the next gas year in February was attractive, a further modification proposal could be raised along these lines. SGD suggested that this issue, however, did not appear to be sufficient to undermine the increased efficiency afforded by this Proposal.

Transco's response

Transco acknowledges the comments raised in respect of the timings of the capacity to be offered.

If implemented, Transco can advise that the timings and the relevant quantities of entry capacity to be offered (excluding any obligated or non-obligated incremental capacity) of the different auctions would be :

- Aug. '03 - MSEC for 6 months Oct. '03 to Mar. '04
(100% SO baseline quantities)
- AMSEC for 12 months Oct.'04 to Sept.'04
(Unsold from 80% LTSEC)
- Sept. '03 - LTSEC for Oct. '05 - Sept. '18
(Unsold from 80% LTSEC , except last 12 months being 80% LTSEC)
- Feb. '04 - MSEC for 6 months Apr. '04 to Sept. '04
(100% SO baseline quantities)
- Aug. '04 - MSEC for 6 months Oct. '04 to Mar. '04
(Unsold from 80% LTSEC & 20% held back)
- AMSEC for 12 months Oct.'05 to Sept. '06
(Unsold from 80% LTSEC)
- Sept. '04 - LTSEC for Oct. '06 to Sept. '19
(Unsold from 80% LTSEC , except last 12 months being 80% LTSEC)
- Feb. '05 - MSEC for 6 months Apr. '05 to Sept. '06
(Unsold 80% & 20% heldback)

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

As no changes to Transco's UK Link system are envisaged, a programme of works will not be required.

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

The development of an implementation timetable is subject to the Ofgem decision on the Proposal.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not support 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 not to modify the Network Code and Transco now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Signed for and on behalf of Transco.

Signature:

Nigel Sisman

NT & T

Date: