

**Modification Report**  
**Summer 2002 Capacity Auction**  
**Modification Reference Number 0549**  
Version 2.0

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**

It is proposed that a number of amendments are made to the Network Code and implemented prior to the next Monthly System Entry Capacity (MSEC) auctions. If unchanged the Network Code requires that the next MSEC auctions will be completed not later than August 2002 and that the quantities to be offered should be over a 12 month period and be based on the SND + 10% methodology. In addition to the MSEC auctions, the Network Code provides for Monthly Interruptible System Entry Capacity (MISEC) and Unsold Long Term Firm (ULTF) to be made available.

### **Completion Date**

It is proposed that the allocation process of the next MSEC auctions should be completed by 31 July 2002. This will have a number of benefits if Modification Proposal 0500 is to be implemented. It will ensure a reasonable time period is available for the Long Term Capacity Allocation systems to be tested and operated during August and for a rolling MSEC process to be operated subsequently.

### **Applicable Period of Capacity Allocation**

The forthcoming allocation of MSEC capacity applies to the 12-month capacity period 1 October 2002 to 30 September 2003. During Capacity Workstream discussions a number of industry parties have discussed the merits of an allocation that covers a 24-month duration (1 October 2002 through to 30 September 2004). This modification proposal provides an opportunity to amend the capacity period and views on this aspect are sought.

### **Initial NTS SO Baseline Entry Capacity**

It is proposed that transitional rules are introduced to enable a proportion of NTS SO baseline entry capacity to be offered. The quantities would be 100% of the NTS SO baseline entry capacity for the 12-month period from 1 October 2002 and if capacity is offered for a 24 month period, 80% of the NTS SO baseline capacity for the 12-month period from 1 October 2003. For clarity a table of relevant initial NTS SO baseline capacities can be found on Table A2 of Ofgem's proposed licence modifications (Transco Price Control and NTS SO Incentives 2002-7). If this Modification Proposal is implemented the above baseline quantities would be published in Transco's transportation statement.

### **Auction of MSEC**

It is proposed, consistent with the February 2002 MSEC auction, that the auction is conducted over 4 rounds in which 25% of available capacity is offered in each round. Any unsold capacity arising from rounds 1 to 3 should be carried over to round 4. It is proposed that the existing round 5 allocation arrangements are not required because the function of this round was in part intended to enable an optimisation of demand across all ASEPs. A requirement to offer preset quantities of capacity is expected to remove the potential for such optimisation. The 5th round allocation is at present required to offer unsold capacity arising from earlier auction rounds, and as previously indicated, Transco believes that it would be appropriate to carry unsold capacity into the 4th auction round.

### **Later application for Monthly System Entry Capacity**

It is proposed that the MSEC allocation process for release of unsold System Entry Capacity as identified in B2.4 is discontinued for capacity to be used from 1 October . It is anticipated that if approved, Modification Proposal 0500 will introduce a rolling MSEC allocation that is intended to replace the present allocation process for unsold system entry capacity. Continuation of the present process after the summer MSEC allocation could therefore create difficulties in migrating to the proposed rolling MSEC process. If Modification Proposal 0500 is not implemented then Transco would expect to raise a further Modification Proposal to introduce a rolling MSEC allocation prior to 1 October 2002.

### **Monthly Interruptible System Entry Capacity (MISEC)**

Transco proposes that provision of MISEC is discontinued. This aspect had previously been removed on a transitional basis by Modification Proposal 0499 (for the period 1 April to 30 September 2002). MISEC was created to overcome industry concerns about the SND based methodology described within the Network Code for determining quantities of MSEC to be offered at each ASEP. However, as previously indicated, this Modification Proposal also contains a proposal to supersede that methodology by utilising a reference to the appropriate proportion of initial NTS SO baseline entry capacity quantities expected to be identified in Transco's Gas Transporter Licence. Transco believes that the use of an initial NTS SO baseline entry capacity measure is intended in part to remove doubts about how available System Entry Capacity is calculated. The need for MISEC as a means of countering doubts about how capacity is calculated are therefore removed and consequently Transco believes that MISEC provision should be removed from the Network Code.

## **2. Transco's Opinion**

Transco supports implementation of all aspects of this Modification Proposal except removal of Later Application for Monthly System Entry Capacity and a change in the completion date. This Modification Proposal primarily seeks to align the quantities of system entry capacity to be offered in the MSEC auctions in July 2002, with the Baseline Capacities that have been proposed by Ofgem and which, have been included in Ofgem's recently proposed modifications to Transco's Gas Transporter Licence. Transco recognises that the use of Baseline Capacity impacts on a number of areas within the Entry Capacity Regime. Transco also supports implementation of the proposed changes to auction design by removing the obligation to run a fifth auction round and to offer MISEC.

Transco considers that removal of Later Application for Monthly System Entry Capacity should best be considered as part of Modification Proposal 0500. Users would then receive a firmer assurance that a replacement capacity release process would be implemented if the existing process is removed.

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

Transco considers that this Proposal would better facilitate the relevant objective of the efficient discharge of its licence obligations. Transco is also of the opinion that the 5th round and MISEC provisions are inconsistent with the principles underpinning the formulation of Baseline Capacity measures and therefore could provide inefficiencies if they were to remain in the Network Code, discouraging economic and efficient operation of the system.

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

This modification proposal will, if implemented align the Network Code arrangements with the System Operator Incentives proposed by Ofgem. In particular the Network Code will reflect the quantities that Transco would be obliged to offer by its licence requirements were the Licence modification proposal to be implemented.

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

There are no such costs.

**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:**

There are no such costs anticipated.

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

There are no such implications anticipated

**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 does not believe there are any such consequences.

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

There are no development implications.

**7. The implications of implementing the Modification Proposal for Users**

Transco would welcome user's views on the implications of implementing this modification proposal.

**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 unaware 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 is unaware of any such consequences.

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

Advantages:

The Modification Proposal will align the Network Code with Ofgem's final proposals for System Operator incentives.

The Modification proposal is consistent with an intent to enable Baseline Capacity to be offered in an MSEC allocation.

Disadvantages:

No disadvantages anticipated.

## **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 18 respondents:-

BG Gas Services Ltd	(BG)
Powergen (UK) Ltd	(Powergen)
British Gas Trading	(BGT)
Agip (UK) Ltd	(Agip)
TXU Europe Energy	(TXU)
TotalFinaElf Exploration UK Plc	(TFE Exp)
TotalFinaElf Gas & Power Ltd	(TFEG&P)
Statoil (UK) Ltd	(Statoil)
Chevron (UK) Ltd	(Chevron)
Dynegy UK Ltd	(Dynegy)
ExxonMobil	(ExxonMobil)
Scottish & Southern Energy	(SSE)
Conoco (UK) Ltd	(Conoco)
Marathon Oil Ltd	(Marathon)
BP Gas Marketing Ltd	(BP Gas)
Innogy Plc	(Innogy)
Shell Gas Direct	(Shell)
Phillips Petroleum Co Ltd	(Phillips)

Respondents generally do not express an all-inclusive opinion of the Modification Proposal but are supportive with the principles, preferring to express specific views on each particular element of the Proposal.

The respondents express the following views for each specific element proposed within the Modification Proposal: -

### **11.1 Period Of Capacity Allocation**

Of the responses received the following numbers expressed support for the differing options:

Six respondents support a six-month period.

Nine respondents support a twelve-month period.

One respondent express support for a twenty-four month period.

In addition ExxonMobil expressed support for a twenty-four month period conditional on offering 100% of Baseline for both years, if some capacity is to be held back for a short term allocation then it would switch support to a twelve-month period.

BP expressed equal support for a six-month or twelve-month period.

The majority of the respondents made comment on the regime uncertainty in relation to proposed amendments to Transco's GT Licence and proposed Long-Term capacity allocation arrangements.

BGT argued that there is a certain attraction to replicating recent experience of six-monthly auctions, but on balance BGT believes that it is now appropriate to move to an annual process, on the basis that 100% of baseline capacity for the period is offered for sale. Following a number of six monthly auctions Users are now familiar with the mechanisms available and should be in a position to forecast their needs in sufficient detail for that period. The move to a twelve-month process also fits well with the transition to the long-term allocation process as proposed in Modification Proposal 0500. BGT is of the opinion that the inclusion of a second year would add unnecessary complication to the process, particularly as only 80% of capacity could be made available in the second year, and there would be only a short time before the auctions to understand all the implications for bidding.

With regard to the auction of the Entry Capacity for year two (October 2003-September 2004), BGT believes that this should be offered as a further-twelve months MSEC auction when 100% of the Capacity can be offered for sale. BGT can see little point in an auction when for 80% of Baseline Capacity, which would be followed by sale of the remaining 20% falling into the rolling MSEC process at the relevant time.

Chevron stated that the maximum period offered should be for twelve-months. Chevron suggested that it is premature to auction capacity for a twenty-four month period given the uncertainties surrounding the Long-Term product and the transition process. It argued that it might even be preferable to reduce the period offered to six months.

Dynegy argued that a continuation of existing arrangements for at least twenty-four months would allow Transco and its customers sufficient time to develop and consult upon the System Management Principles and Transco's Balancing Principles, in order for the long-term capacity regime to function efficiently.

Phillips suggests that the industry recognises the need to auction capacity for a longer time horizon. However, while waiting the outcome of consultation on the two long-term proposals, it seems too early to change the short-term auction time horizon from six months.

**Transco response:**

Transco recognises respondents concerns about uncertainties in the future shape of the commercial regime. In particular Transco understands that many respondents are not comfortable about making long-term commitments until the proposed GT licence amendments are resolved. Transco therefore agrees that an allocation of twenty-four months is inappropriate at this stage and it also recognises that the arguments between six and twelve months are finely balanced. In this instance Transco is happy to be guided by majority opinion and is willing to support a twelve-month allocation.

**11.2 Completion Date Of MSEC Auction**

Six respondents stated a preference for completion of MSEC auctions during July.

Five respondents stated a preference for completion during August.

Two respondents suggested a delay to the proposed 31st July 2002 date but did not express an alternative preference. Phillips commented that it had no objection to either July or August 2002.

BGT stated that the timing of the auction process should afford a period of stability before and after the process. Participants in the process need certainty of the product when bidding and it is inappropriate for there to be changes to the regime, which may alter the product, immediately before the auction or between the auction and the capacity being used. Therefore, it is BGT's view that an auction held in July 2002 will facilitate this, subject to a decision being made as soon as is possible, but no later than two weeks before the auctions are due to take place.

Innogy comments that they agree that the next MSEC auctions should be completed by the end of July 2002. Further, it strongly believes that once the dates have been set that they should not be moved.

TFE Exp argued that the MSEC allocation process should be held in August. This would then provide adequate time for shippers to review the conclusions of Ofgem's Licence amendment consultation and the long-term entry capacity consultation, both of which it expects to be published towards the end of July 2002. Chevron also supports the maintenance of the 31st August completion date as specified in Network Code.

Phillips states that the current proposal to hold auctions in either July or August does not allow sufficient focused time to prepare a bid strategy and obtain management approval for the August long-term auctions. It is necessary to have at least two clear months between agreement of the long-term entry capacity regime and the start of the allocation process in order that companies can review their positions and understand the process at all levels.

ExxonMobil supports the allocation process being completed by 31 July 2002 subject to there being a period of at least two weeks between finalisation of all terms associated with the MSEC auctions and the start of the MSEC auction process. ExxonMobil would expect Ofgem to have published its decision on this Modification Proposal by the end of June and they would not expect any further Modification proposals to be raised for the period covered by the MSEC auctions that could have an impact on shippers' bidding strategies. If either of these conditions is not met, ExxonMobil would expect Transco to raise a further Modification Proposal to delay the start of the MSEC auction process.

SSE is strongly of the view that due consideration must be given to the time allowed for implementing the proposal, bearing in mind that it is inextricably linked to the introduction of the new price control and SO incentives, and neither can progress in isolation. SSE advocates that the MSEC auctions must not be implemented until there is clarity about the relationship between the auctions and transportation charges and sufficient time must be afforded for players to familiarise themselves with the detail before the next round of MSEC auction changes are finally introduced.

### **Transco response**

Transco originally believed that a decision could be made on this Proposal before the end of June. That would leave two weeks before the MSEC allocation process would begin on 18 July. Completion of the allocation on 31 July would then allow a two-month period before use of capacity from 1 October. Against this background, Transco suggested a July completion in the Modification proposal in order to simplify implementation of potential long-term capacity arrangements during August. Transco recognises that there is considerable concern amongst Users to understand the content of any revised GT Licence conditions and associated documents before committing to any allocation process. On that basis Transco agrees that this aspect of the proposal should not be implemented and that the completion date should be as presently specified in the Network Code (i.e. before 31 August). Transco would then anticipate effecting a two-week delay to the previously indicated start date so that MSEC allocation could start on 1 August with completion 14 August. Long-term capacity allocation could then take place from early September.

### **11.3 Initial NTS SO Baseline Entry Capacity**

Twelve respondents expressed support for the proposal to offer 100% of SO baseline capacity in 2002/03. Five further respondents offered no comment on this aspect of the proposal and one argued that 110% of SND should be offered. Of those in support one respondent qualified its support by expressing a preference for allocating a six-month period. A further four respondents argued that if capacity is offered for 2003/04 then the quantity to be offered should also be 100% of initial NTS SO baseline capacity.

BGT stated that they continue to support a 'Top Down' methodology for identification of initial quantity of entry capacity to be sold. This is now defined as 'Baseline Capacity' being 90% of maximum physical capacity of each terminal as defined in the proposed licence amendments. It strongly supports the view that 100% of this Baseline Capacity should be offered for sale in all periods.

Agip believes that the volume of capacity to be offered should be retained at current levels. This is the basis of the current SO incentive arrangements and scant justification is proposed for Transco's proposed amendments. Network Code states that 110% of SND should be offered. Agip does not, therefore, support the proposal to reflect the draft Gas Transporters Licence modifications of offering 100% of Baseline Entry Capacity.

#### **Transco response.**

Transco agrees that 100% of Initial NTS SO Baseline Capacity should be offered in the year from 1 October 2002. If an allocation is offered for capacity from 1 October 2003 then the quantity to be offered should be 80% of Initial NTS SO Baseline Capacity as indicated in the proposed GT Licence amendments. If directed to implement this proposal, all quantities will be identified in Transco's Transportation Statement.

### **11.4 Auction of MSEC**

Thirteen respondents expressed support to continue with the removal of the fifth round capacity auction and conducting a four round auction in which 25% of available capacity is offered for sale in each round. Any unsold capacity from round one to three would be carried over to round four.

There were no negative responses recorded regarding this proposed change to the process.

### **11.5 Later Application for Monthly System Entry Capacity**

Seven respondents are in support of this element of the Modification Proposal and three respondents are against.

Agip states that it supports the removal of this service only if a rolling MSEC allocation is implemented and effective from 1st October 2002. It is Agip's belief that shippers should be provided with a further opportunity to purchase MSEC rather than having to face the risk of being unable to obtain their requirement in DSEC auctions.

Innogy comments that replacing the ULTF with a monthly rolling MSEC auction aligns the monthly allocation with the proposed annual allocation process, is more consistent with release mechanisms used elsewhere and allows for unsold MSEC to be released nearer to the month of gas flow. Innogy therefore supports the introduction of the rolling MSEC product.

Statoil comments that it wishes for no decision to be taken yet about when to discontinue the off-the-shelf product.

ExxonMobil states that it does not believe that shippers should be faced with uncertainty when they are participating in the MSEC auctions, as to what mechanism would be in place to enable them to acquire MSEC after the primary allocation process has been completed.

SSE expressed concern that a rolling MSEC allocation would limit the frequency of opportunities for Users to obtain unsold Entry Capacity.

### **Transco Response**

Transco is pleased with the level of support for discontinuing use of later application for Monthly System Entry Capacity. However it notes the general view that this part of the proposal should be considered in the context of introducing a Rolling Monthly System Entry Capacity auction and therefore is of the opinion that this issue is best considered as part of Modification Proposal 0500. In that Modification, Transco has proposed that a Rolling MSEC allocation should be implemented.

### **11.6 Monthly Interruptible System Entry Capacity (MISEC)**

Twelve respondents support the removal of the provision of MISEC from Network Code.

Agip did not express support for the removal of MISEC. Agip state that it believes that MISEC provides the community with additional means of acquiring entry capacity on a longer-term basis that does not incur buyback costs and is a useful anti-hoarding measure.

In general the respondents that express support for this element of the proposal consider that there is no longer a requirement for a Monthly Interruptible product.

BGT believes that the existence of the Monthly Interruptible product at this time undermines the value of Firm Entry Capacity and development of a secondary market for Entry Capacity.

Shell Gas Direct does not see any requirement for Transco to auction MISEC. Releasing MISEC was a method of ensuring that Transco had released all available capacity against a regime where SND was sold in the primary auction.

### **Transco response**

Transco welcomes the high level of support for this aspect of the proposal. It believes that MISEC was developed to overcome concerns about the release of MSEC quantities when determined by a SND based methodology. Replacement of SND with Initial NTS SO Baseline Capacities removes this concern.

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

Implementation is not required to facilitate compliance with any such legislation.

**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 proposed change in the methodology established under Standard Condition 4(5) of the statement furnished by Transco under Standard Condition 4(1) of the Licence.

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

There are no such works required.

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

Draft Modification Report	24 May 2002
Close out for representations	18 June 2002
Final Modification Report	21 June 2002
Revised Final Modification Report	5 July 2002
Ofgem decision expected	9 July 2002

**16. Recommendation concerning the implementation of the Modification Proposal**

Transco recommends that this proposal be implemented.

The authority is asked to note that the proposals concerning Later Application for Monthly System Entry Capacity and auction completion by 31st July have been withdrawn.

**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.

Following consideration of Users' representations, Transco proposes that the following be implemented:

Period of capacity allocation	12 months
Capacity to be offered	100% of NTS SO Baseline
Auction of MSEC	4 rounds of 25% each, unsold capacity offered in 4th round
Monthly Interruptible Entry Capacity	removed from Network Code

## 19. Text

### TRANSITION DOCUMENT, PART II

*Delete Paragraph 8.1.3*

*Replace as follows:*

8.1.3 B2 In respect of the calendar months October 2002 to September 2003 (inclusive) (“relevant month”):

- (1) Section B2.2 shall not apply and for the purposes of Section B2.3:
  - (a) references to Determined System Entry Capacity in respect of an Aggregate System Entry Point and each relevant month shall be treated as a reference to the amount of System Entry Capacity identified as the [Output ASEP Quantity] for the Aggregate System Entry Point and the relevant month set out in Transportation Statement ;
  - (b) the reference in Section 2.3.1 to each calendar month in the Gas Year shall be treated as a reference to each relevant month;
  - (c) Transco’s invitation under Section 2.3.2 shall specify four dates, the last of which shall not be later than 31 August 2002 and the amount of System Entry Capacity that will be available on the first three invitation dates shall be an amount equal to 25% of the amount of System Entry Capacity determined in accordance with paragraph (1); and on the fourth date shall be an amount equal to such amount of System Entry Capacity that remains available after [allocation] in accordance with Section 2.3 following the third invitation date.
- (2) Sections B2.6 and B2.7 shall not apply.

Signed for and on behalf of Transco.

Signature:

**Tim Davis**  
**Head of Regulation 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 **0549**, version **2.0** dated **05/07/2002**) 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 appropriateprovided 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.