

URGENT Modification Report
Inclusion of Unsold Baseline Capacities in Day Ahead Capacity Auctions
Modification Reference Number 0541

Version 1.0

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

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because Transco anticipates revised SO incentives being implemented via revisions to its GT Licence with effect from 1 April 2002. However, these licence amendments will not be finalised before 1 April. It is anticipated that once finalised, the Licence amendments will be applied retrospectively and take effect from 1 April. Urgent status was therefore sought for this proposal to ensure that new arrangements can be put into effect from 1 April 2002 through transitional arrangements in the Network Code. Ofgem have agreed that this Proposal be given urgent status to provide Transco and shippers with greater certainty about the transitional arrangements for Transco's obligations with regards to the treatment of unsold baseline capacity. If approved the transitional arrangements will take effect from 1 April 2002.

Procedures Followed:

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

Issued to Ofgem for decision on urgency	8 March 2002
Proposal agreed as urgent	8 March 2002
Proposal issued for consultation	8 March 2002
Close out for representations	20 March 2002
Final report to Ofgem	22 March 2002
Ofgem decision expected	28 March 2002

1. The Modification Proposal

The purpose of this proposal is to amend the existing Network Code rules for determination of the amount of Daily System Entry Capacity to be offered for sale such that it includes any unsold baseline capacity. The unsold baseline capacity will be offered for sale in auctions held at the day ahead stage. Revenues from such sales of baseline capacity would count towards TO Allowed Revenue as described in Modification Proposal 0539.

2. Transco's Opinion

Transco supports this Modification Proposal, as it believes the implementation of this Proposal is required to facilitate the implementation of Ofgem's final proposals in respect of Transco's NTS System Operator incentive scheme. Implementation would enable Transco to fulfil its anticipated obligation to offer any unsold baseline capacity at the day ahead stage. The allocation would be conducted through the existing Daily System Entry Capacity allocation process.

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

This proposal was raised in anticipation of changes to be proposed by Ofgem through Licence amendments. These changes would facilitate compliance with the relevant objective contained within Standard Condition 9(1)(b), i.e. the efficient discharge, by Transco, of obligations under its GT Licence.

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

There are no such implications

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:

Any additional System Operator costs incurred as a result of implementing this Proposal would be accounted for under the proposed internal cost incentive scheme, as set out in Ofgem's final proposals for the System Operator incentives.

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

There are no such implications.

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

If this proposal is implemented it will provide certainty for Users concerning the arrangements for the purchase of entry capacity at the day ahead stage in the absence of Transco's revised GT Licence which is expected to be implemented with effect from 1 April 2002. It will also maximise Users' access to baseline capacity.

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

There are no 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

This Proposal would ensure that Transco fulfils its proposed Licence obligation to continue to offer unsold baseline capacity up to and including the day before the gas flow day.

The anticipated licence amendments alluded to in this Modification Report are based on Transco's understanding of Ofgem's final proposals for Transco's SO incentives. The proposed licence amendments are to be the subject of a consultation under section 23 of the Gas Act 1986 and no assumptions can be made regarding the outcome of that process.

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

Advantages:

- It will ensure that Transco complies with anticipated amendments to its GT Licence.

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 eight respondents:

Agip (UK) Ltd (Agip)
Shell Gas Direct Ltd (SGD)
Norsk Hydro (UK) Ltd (Norsk Hydro)
TotalFinaElf Gas & Power Ltd (TFE)
Scottish & Southern Energy Plc (SSE)
Innogy Plc (Innogy)
British Gas Trading Ltd (BGT)
London Electricity (LE)

Four respondents (Agip, Norsk Hydro, Innogy, LE) support the Proposal.

Two respondents (SGD, TFE) do not support implementation of the Proposal.

Two respondents (SSE, BGT) do not express a definitive position in respect of this Modification Proposal.

Delay to Licence

Six respondents (SGD, Norsk Hydro, TFE, SSE, Innogy, BGT) commented on the process surrounding the implementation of the amendments to Transco's GT Licence. SGD has "concerns about the processes being followed to introduce Transco's licence implementing its

new price control and associated system operator incentives” and Innogy comment that the “delay has required urgent modification to the network code rather than considered amendment to Transco’s GT Licence”.

Three shippers (Norsk Hydro, Innogy, TFE) find it difficult to comment on this Proposal before Transco’s revised Licence has been published. Innogy state that the Proposal “appears consistent with the high level principles set out the final SO proposals” but “find it difficult to comment meaningfully without having seen the detailed licence proposals”. Norsk Hydro state that it is “presented with partial information and an incomplete process, which is totally unacceptable”

TFE find it “unacceptable that by raising this proposal Transco is seeking to introduce contractual changes, which contain significant commercial implications to both shippers and Transco, whilst effectively hedging its own commitment to these changes”.

Transco Response

Transco sympathises with User’s views concerning the delay to publication proposals to modify its GT Licence. Transco believes, however Ofgem has indicated in published documents that Transco should be obliged to offer unsold baseline capacity up to and including the day ahead.

Modification Timescales

Three shippers (Innogy, BGT, SSE) are particularly concerned about the timescales associated with this Proposal. Innogy is concerned that “there is significant risk that insufficient consideration is given” to this proposal. SSE is uncomfortable that Ofgem is not expected to make a decision until 28 March and is “concerned that this leaves shippers and other interested parties little time to amend their processes to take account of these potential changes”. BGT believe that “ the short timescale will inevitably result in the need for manual processes to manage routine operations, which itself further adds to the risk and uncertainty experienced”.

Transco Response

Transco is sympathetic to Users' concerns about the short timescales for this Proposal and following further discussions with Ofgem it is Transco’s belief that Ofgem intend to make a decision on this proposal as soon as possible.

Transco agrees with BGT that a manual process may be required as an interim step until systems can be developed.

Capacity Available

Three respondents (LE, Agip, SSE) support the principle that unsold baseline capacity should be offered for sale on the day ahead and that the revenues from such sales should be part of Transco’s allowed revenue. However, Norsk Hydro are concerned “that it is not clear how

capacity over and above baseline would be made available to shippers on a short term basis”. It believes that this is not an issue for the forthcoming summer, but that “next winter could see a demand for capacity greater than the baseline capacity level, particularly at St Fergus. SGD did not understand that Ofgem’s final proposals for SO incentives included an obligation on Transco to “sell up to its baseline capacity levels”. It raises the issues of how any over recovery resulting from the implementation of this Proposal and Modification 539 would be treated. SGD is also concerned that “by possibly selling more than Transco believes it can deliver at the day ahead stage, this may increase the potential for buy backs. Costs of buy backs are shared with shippers and this requirement can significantly increase price risk for holders of firm capacity as a greater, unknown amount of buy back costs may be smeared to them.”

Transco Response

Transco welcomes support for offering unsold baseline at the day ahead stage and wishes to reassure Users that where further capacity is available it would be offered for sale subject to Transco’s assessment of risk and reward under its Incentive arrangements.

Transco currently anticipates that any over recovery against allowed revenue resulting from this Proposal would be passed through the “K” mechanism.

Transco believes that Ofgem has indicated in published documents that Transco should be obliged to offer unsold baseline capacity up to and including the day ahead stage.

Future Implications of the Proposal

Three shippers (SSE, Innogy, LE) request clarity on the mechanism by which the process described in this Proposal will be removed from the Network Code once the licence amendments are implemented and SSE suggests that this “could be facilitated via further consultation on Modification 520 (Removal of entry capacity incentives from the Network Code), in accordance with Modification Rule 8.10.1(b) as the circumstances relating to it would have materially changed”. Innogy also ask how Modification Proposals 519 and 520, and Pricing Consultation 72 interact with this proposal.

SSE is also concerned that there may be a requirement for a reconciliation process following implementation of Transco’s amended Licence.

Transco Response

Transco does not intend that this proposal, if implemented, would need to be removed from the Network Code as it is expected give effect to ongoing obligations anticipated to be contained within Transco’s GT Licence. There is therefore no interaction between this proposal and Modification Proposals 519 and 520. If Pricing Consultation 72 is implemented then capacity offered for sale under this process would have a zero reserve price.

Relevant Objectives

SGD does not consider that this proposal furthers the relevant objectives of the Network Code. It states “this modification undermines the economic and efficient operation of the

pipeline system by increasing risk to shippers. It cannot be stated that it is consistent with the efficient discharge of Transco's obligations under its licence in the absence of any draft licence conditions to which this proposal can be compared.”

Transco Response

Transco does believe that this Modification Proposal furthers the relevant objectives and will enable Transco to comply with its proposed Licence obligations as understood by Transco when they are implemented with effect from 1 April 2002.

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)

Final Modification Report issued	22 March 2002
Ofgem decision expected	28 March 2002
Implementation	1 April 2002

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this proposal be implemented.

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

TRANSITION DOCUMENT, PART II

Add new paragraph 8.1.3B to read as follows:

- "B2.5 In respect of a Day in the calendar months April 2002 to September 2002 (inclusive) in relation to an Aggregate System Entry Point:
- (1) where Transco undertakes a capacity allocation on the Preceding Day the ASEP Specific Available Daily Capacity in respect of the Aggregate System Entry Point shall be the greater of:
 - (i) the amount of System Entry Capacity that would be determined as such in accordance with Section B2.5; and
 - (ii) the amount by which the Output ASEP Quantity, for the Aggregate System Entry Point and the calendar month in which such Day falls, exceeds the Aggregate Firm Registered Capacity for the Day;
 - (2) the Capacity Charges payable to Transco in respect of Daily System Entry Capacity allocated on the Preceding Day shall, where the Aggregate Firm Registered Capacity for the Day exceeded the Output ASEP Quantity, for the Aggregate System Entry Point and the calendar month in which such Day falls, be treated as Relevant Capacity Revenues for the purposes of paragraphs 8.1.11 (notwithstanding paragraph 8.1.12) and 8.1.13 of this Part II, but not otherwise."

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 **0541**, version **1.0** dated **25/03/2002**) 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 **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.