

Modification Report
Transition Arrangements for Long Term Capacity Allocation
Modification Reference Number 0499
Version 2.0

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

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. As a consequence of the implementation of Modification Proposal 0505 - Delay to the January 2002 MSEC Allocation, the next MSEC auctions are due to be completed not later than 28 February 2002. It is the intention of the Proposer that the changes, if approved should apply in relation to the notification, sale and administration of MSEC for the capacity period starting on 1 April 2002.

Applicable Period of Capacity Allocation

The Network Code provides that the forthcoming MSEC Allocation of capacity applies to the 6-month capacity period 1 April to 30 September 2002. This modification proposal provides an opportunity to amend the capacity period to a 12 month duration (1 April through to 30 March 2003). Transco believes Users should have an opportunity to consider the appropriateness of this potential change.

Date for Completion of MSEC Allocation.

This was consulted upon separately within Modification Proposal 0505 - Delay to the January 2002 MSEC Allocation. The proposed delay to the January 2002 Allocation was subsequently implemented with a completion date of no later than 28 February 2002.

Output Measures

Output Measures have been linked to Transco's Price Control and are expected to be specified within its Gas Transporter licence. It is proposed that section B2.2, which identifies the process of calculating Determined System Entry Capacity is replaced with a reference to the appropriate Output Measures (or a proportion thereof). The reference should indicate that the quantity of System Entry Capacity to be made available in each relevant month and at each Aggregate System Entry Point (ASEP) should be as indicated in the relevant table of Output Measures and derivatives. Users should be aware that alternative measures might need to be taken if agreed text for any forthcoming licence change is not put in place prior to the MSEC auctions. If Output Measures and the appropriate proportions to be offered for sale are not specified in time for the forthcoming allocation then Transco presumes that transitional Network Code provisions will need to be developed. These should provide for an appropriate quantity to be offered in the allocation of January/February 2002. Following the issue of Ofgem's Final Proposal for Transco's NTS System Operator Incentives the minimum quantity of System Entry Capacity to be offered will now be referred to as Baseline Capacity.

Auction of MSEC

It is proposed 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 capacity up to preset Output Measures 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

Following the MSEC allocation process any unsold System Entry Capacity is offered on a first come first served basis with a reserve price that is applicable only to System Entry Capacity released through this particular process. Transco does not believe that this process adds significant value to the Entry Capacity regime. From 1 April 2002, capacity will be made available in the primary release up to the appropriate proportion of the Output Measure and Daily System Entry Capacity (DSEC) will where appropriate, also continue to be made available. Transco believes that the MSEC and DSEC processes should offer adequate opportunity for Users to obtain System Entry Capacity and therefore proposes that provision of this service is discontinued (section B2.4).

Monthly Interruptible System Entry Capacity (MISEC)

Transco proposes that provision of this feature of the entry capacity regime is discontinued. MISEC was created to overcome industry concerns about the methodology described within the Network Code for determining quantities of MSEC to be offered at each ASEP over the relevant period. However as previously indicated, this Modification Proposal also contains a proposal to supersede that methodology by utilising a reference to the appropriate proportion of Output Measure quantities identified in Transco's Gas Transporter Licence. Transco believes that the use of an Output Measures based approach is intended in part to remove doubts about how 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 related provisions should be deleted from the Network Code.

2. Transco's Opinion

This Modification Proposal primarily seeks to align the quantities of system entry capacity offered in the MSEC auctions in February 2002 with the Baseline Capacities that have been proposed by Ofgem and which, if agreed, are expected to be included in Transco's Gas Transporters Licence. Transco recognises that the use of Baseline Capacity impacts on a number of areas within the Entry Capacity Regime. Although enduring changes should be considered in the context of a separate Modification Proposal, in Transco's opinion the short term effects and appropriate transitional arrangements need to be considered. 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 believes

the period for which capacity is offered should remain at six months in the light of continuing uncertainty about the future commercial regime.

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 by ensuring that MSEC quantities are in line with potential licence requirements. Transco is also of the opinion that 5th round and MISEC provision 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 expected to be proposed as license changes from 1 April 2002. In particular the Network Code will reflect the quantities that Transco would be obliged to offer by its license requirements were the expected Licence Modification Proposal to be accepted.

b) development and capital cost and operating cost implications:

No such costs are anticipated.

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:

Transco does not anticipate that the implementation of this Modification Proposal would create costs that it would seek to recover.

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

Transco is unaware of any 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 is unaware of any such consequences.

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

Transco is unaware of any such implications.

7. The implications of implementing the Modification Proposal for Users

Users will benefit from this proposal if the quantities to be offered in the next round of the MSEC auctions are aligned with the forthcoming System Operator Incentives. This Modification Proposal is consistent with an intent to enable Baseline Capacities to be offered in an MSEC allocation.

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 potential licence obligations for the System Operator Incentive.
- The Modification proposal is consistent with an intent to enable Baseline Capacity to be offered in an MSEC allocation.

Disadvantages :

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

Representations have been received from 13 respondents:-

Norsk Hydro (UK) Ltd	(Norsk Hydro)
Marathon Oil UK Ltd	(Marathon)
Agip (UK)	(Agip)
Statoil (UK) Ltd	(Statoil)
BP Marketing Ltd	(BP)
Scottish & Southern Energy plc	(SSE)
TotalFinaElf Gas and Power Ltd	(TFE)
Shell Gas Direct Limited	(SGD)
TotalFinaElf Exploration UK	(TFEEUK)
TXU Energy UK Gas Trading	(TXU)
ExxonMobil	(ExxonMobil)
Powergen	(Powergen)
British Gas Trading	(BGT)

BGT and AEP express support for the Modification Proposal.

Agip is broadly not in support of the Modification Proposal. Respondents generally do not express an all-inclusive opinion of the Modification Proposal, preferring to express specific views on each particular element of the Proposal.

Statoil states that whilst it appreciates the need for the Network Code to appropriately reflect entry capacity transitional arrangements it is concerned by the number of issues contained in this Modification Proposal. Statoil finds it difficult to understand how a decision can be made on the implementation of this Modification when it is possible that only parts of the proposal may facilitate the relevant objectives.

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

Applicable Period of Capacity

Eleven respondents support a continuation of the present six month period for the forthcoming auction.

One respondent expressed support for twelve months.

One respondent did not express a preference.

Nine respondents express the view that retention of the 6 month auction period would have the advantage of aligning any wider changes to the capacity regime, as proposed in Modification 0500 - Long Term Capacity and 0508 A Method of Long Term Capacity Allocation, with the start of the gas and contract year.

ExxonMobil states that it could support either a six or twelve month period. It observes that, on the basis that current schedules for finalising Long Term Capacity Arrangements are proposed to be implemented by October 2002, for the purposes of consistency, it could support a final six month auction. ExxonMobil notes that ordinarily it would support the sale of entry capacity as far ahead as possible. BGT also expresses a preference for an auction of twelve months capacity as it considers that February/March is an appropriate time in the year to commit to both the summer and winter capacity requirements. BGT state that it has always maintained that the offer of a longer term service will bring greater stability to the allocation of entry capacity. However BGT recognises that the current objective under development within the RGTA workstream is to implement this process for the sale of capacity from October 2002 and therefore it is supportive of a six month auction to bridge the gap until the longer arrangements are in place. BGT continues that if there is any prospect that the longer term process was not delivered until April 2003 then it believes that the process should provide for the sale of capacity until such time within a single auction.

Statoil suggests that it is inappropriate to introduce a twelve month capacity period prior to the implementation of the next Price Control or any new System Operator Incentives. It advises that a six month allocation allows the industry time to assess the workings of the new regime and the risks involved before moving to annual allocations.

Agip notes that should it become apparent that the proposed Long Term Entry Capacity Allocation processes are not in place for October 2002 then the effective date for the longer term arrangements should be put back to Oct 2003. Agip proposes that the deadline for assessing the Long Term Capacity Arrangements should be no later than the end of July 2002.

Norsk Hydro states that the retention of a six month period may allow for further improvements to the existing MSEC auction methodology.

In respect of the proposed twelve month period Norsk Hydro cites concerns that summer MSEC price levels and volatility may spill over into the winter months potentially distorting prices.

BP cites a reduction in administration, without any perceived detrimental effect, as the reason for its support of a twelve month capacity allocation.

Date for Completion of MSEC Allocation

Five respondents support a delay to the auctions, with a completion date no later than 28 February 2002.

Eight do not express an opinion.

Norsk Hydro support is subject to the condition that the period between allocation tranches is extended to four working days. It suggests that this would offer a sufficient period in which the industry may develop more considered bidding strategies and potentially reduce the round on round price volatility.

BGT, ExxonMobil and SSE note that the implementation of Urgent Modification 0505 - Delay to the January 2002 MSEC Allocation, already facilitates a delay to the auction, scheduled to be completed by 28 February 2002. SSE suggests that, on the assumption that the fifth round is dispensed with, it would be helpful to put back the auction start date of the 12 February 2002 to 15 February 2002 to allow as much time as possible to understand and develop bidding strategies.

ExxonMobil advises that should the capacity products for the next auction period not be defined by 28 January 2002, it would expect Transco to seek further views on the auction timetable.

Output Measures

Ten respondents express support for the linkage between capacity quantity at auction and the Baseline Capacity Measures as detailed in Ofgem's SO Incentives Final Proposals Document.

Three did not offer an opinion.

SGD notes that the Modification proposes that section B2.2 be replaced with a reference to the appropriate Output Measures and makes the assumption that the drafting will now reference Baseline Capacity.

Agip considers it appropriate for the Baseline Capacity Measures to be specified within the Network Code, as this allows for them to be challenged and amended through the Modification process.

TXU and SSE observe that the Licence changes will not take effect until 1 April 2002 which will be after the auctions have been conducted. They suggest that the Network Code will need to refer to the specific volumes concerned and/or acknowledge that the Output Measures take effect from the start of the new price control.

Statoil recognises that it may be necessary to provide alternative measures if the Licence amendments are not agreed within the appropriate timescales and urges that Transco raises a Network Code Modification (if required) at the earliest opportunity.

Agip believes that the Baseline Capacity measures should be offered in total for MSEC auctions for the capacity allocation period to September 2002. It proposes that any capacity not sold through the MSEC auction should be made available in the DSEC auctions.

Marathon states that a linkage between capacity quantity available at auction and the Output Measure may introduce transparency and provide more certainty to shippers in respect of future capacity availability.

BGT suggests that this element of the Proposal ensures fair allocation and assists in stabilising capacity prices and any potential impact upon gas and other transportation prices.

Auction of MSEC

Ten respondents express support for the abolition of the fifth round of the auctions.

Two respondents do not record an opinion and one does not object to this element of the Modification Proposal.

SSE suggests that consideration could also be given to rolling forward unsold capacity into each subsequent round.

Marathon advises that its support is based on the proviso that all quantities to be made available are set at the maximum levels.

SGD notes that the original purpose of the fifth round was to optimise demand across the ASEPs when the amounts were based on Seasonal Normal Demand (SND). This optimisation should now be through Transco's actions in operating the system, including Buy-Backs.

Later Application for Unsold MSEC

Three respondents support this element of the Modification Proposal
Seven respondents are not in support.

Two do not record an opinion and one does not object to this element of the Modification Proposal.

SSE considers that Transco has not adequately justified the reason for removing this service.

Norsk Hydro and Agip state that where Transco is in possession of unsold capacity there should be a means for shippers to purchase it. SSE expresses concern that shippers would no longer be able to purchase additional available capacity until the day ahead. Agip observe that the current service provides Users with a further opportunity to buy capacity in monthly strips rather than having to bid in DSEC auctions and facing the risk of not obtaining capacity on some days.

SGD suggests that it is appropriate to no longer have sales of 'off-the-shelf' MSEC. It observes that sales of day ahead capacity should ensure that any capacity remaining unsold is offered to the market. However SGD states that all capacity which would be sold 'off-the-shelf' must come to the market. Marathon support is subject to any unsold capacity being made available day ahead as daily firm. It suggests that the full Output Measure must be made available on every day to avoid a clash between top-down and buy-back methodologies.

BGT observes that if a 12 month auction is to be adopted then there should remain some process by which users can obtain capacity with some certainty for the remainder of the period that the capacity has been auctioned.

Statoil and TFE are of the view that, until such time as the Long Term Entry Capacity regime is finalised, this product should not be removed. Statoil states that the removal of this product would be of particular concern when considering the incentive arrangements of capacity sales at D-1 and D. TFE considers that it would be premature to introduce such a change under the current regime.

BGT and SSE raise concerns over the potential lack of symmetry in how the revenue from sales of unsold MSEC is treated under Transco's Proposal. It observes that Transco's allowed revenue would include all Baseline Capacity. If some of this capacity is not sold as MSEC in the primary auction, Transco could potentially be in an under recovery situation. SSE observes that if the unsold MSEC were to be sold within the DSEC it would be assumed that this revenue would form part of the capacity incentive. This infers that Transco would get the benefit of revenue twice, which is not appropriate.

Agip believes that the appropriate price to be paid for late application for the MSEC is the WAP of all accepted bids, by month, by terminal from the four MSEC auction rounds.

Monthly Interruptible System Entry Capacity (MISEC)

Seven respondents express support for the deletion of MISEC related provisions from the Network Code.

Two respondents were not in support.

Three do not record an opinion and one does not object to this element of the Modification Proposal.

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. Statoil and TXU observe that a monthly interruptible product should not be necessary under an Output Measure based regime. Indeed, Statoil and BGT consider that a monthly interruptible product may undermine the value of any investment signals in the primary allocation process and secondary market activity. It is Statoils view that the only interruptible product to be offered should be daily use it or loose it, as an anti hoarding mechanism.

SGD considers that the Monthly Interruptible product is no longer required given that the volume of capacity set out in the Output Measure will be offered for sale.

Agip believes that the MISEC provides shippers with additional means of acquiring entry capacity on a longer term basis and does not incur buy-back costs.

BP support for this aspect of the Proposal focuses on the relatively low levels of participation in the Monthly Interruptible System Entry Capacity.

Legal Drafting

TFEEUK and SSE observe that there are discrepancies in the draft legal text of the Modification Proposal. They note that the draft refers to a six months duration as opposed to the twelve months proposed within the Modification Proposal.

Implementation

SSE proposes that shippers must be afforded sufficient time to consider all the parameters of the regime and therefore requests that a period of two weeks is allowed between finalising the rules and the start of the auctions. SSE continues that this notice period must not compromise the two business days between rounds. SSE note that this timetable may be achieved prior to the auction completion date of 28 February 2002 if Ofgem make a decision on this Modification Proposal prior to 1 February 2002, assuming that Transco must notify Ofgem of its acceptance, or otherwise, of the SO Final Proposals by the end of this month.

Transco Response

Applicable Period of Capacity

Transco welcomes the broad support for a six month MSEC auction period and will not pursue proposals for a twelve month allocation period commencing 1 April 2002.

Output Measures

Transco does not believe that Licence changes (or accompanying text) will be agreed in time to provide a reference to the Baseline Capacity quantities that are expected to be identified in the Ofgem's proposed changes to Transco's Licence. Transco therefore proposes to provide a table of quantities within the Transportation Statement. The Transition Arrangements of the Network Code will reference the Transportation Statement accordingly. These quantities will be as specified in Ofgem's final proposals document for System Operator Incentives, issued on 14 December 2001.

Auction of MSEC

Transco welcomes the broad support expressed for discontinuing the fifth MSEC round. Transco agrees with SGD's observation that the optimisation function that this round was intended to fulfil can no longer be achieved if Baseline Capacities are fixed. Transco believes it appropriate for all unsold capacity remaining after round 1 to 3 will be offered in round 4.

Later Application for Unsold MSEC

Transco recognises the concerns expressed by a number of respondents. Under this proposal Transco would potentially release daily capacity if the balance of risk and reward was favourable. Transco would not wish to undertake an obligation to offer fixed quantities in the daily release processes. As part of Modification Proposal 0500 - Long Term Capacity - Transco has proposed replacing 'off-the-shelf' capacity with a rolling MSEC process. In view of the concerns expressed Transco would prefer to withdraw this aspect of the proposal and would urge the industry to consider replacing 'off-the-shelf' capacity with rolling MSEC.

Monthly Interruptible

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 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 would potentially facilitate Transco's compliance with revised Licence obligation.

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 with regard to any such proposal.

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

No such program of works is required.

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

The timetable of action consequent upon implementation is set out elsewhere in this report.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of the Modification Proposal as specified elements in this report. The proposed changes are:-

1. Output Measures - Replace B2.2 with a reference to the appropriate Baseline Capacities.
2. Auction of MSEC - Removal of the fifth round from the auction process.
3. Removal of the MISEC auctions.

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

Delete Paragraphs 8.1.3 to 8.1.9 inclusive

Replace as follows:

8.1.3 B2 In respect of the calendar months April 2002 to [September 2002] (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 [Baseline Capacity] for the Aggregate System Entry Point and the relevant month set out in Transportation Statement for the relevant month ;
 - (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 28 February 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 **0499**, version **2.0** dated **15/01/2002**) 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 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.