

Modification Report
Long Term Capacity Allocation
Modification Reference Number 0500
Version 3.0

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

1. The Modification Proposal

Transco proposes that an Entry Capacity allocation procedure is implemented to enable Users to obtain Entry Capacity for future periods up to 15 years ahead. Discussion on this topic has been conducted in the Workstream process. Details of the Workstream discussions are provided in the Modification 0500 Workgroup Report dated 11 January 2002 and are summarised along with the original proposal in Section 1.1 (below). Additional Workstream discussions have taken place during the consultation period and the Modification Proposal has been further developed; these changes are summarised in section 1.2 below. In addition two supplementary consultation's have been issued, and both are also summarised below (in section's 1.3 and 1.4).

1.1 Initial Proposal & Workstream Discussions (as set out in Draft Modification Report)

This section defines the initial proposal and its development up to the issue of the draft modification report. It should be noted that development continued after the publication of the draft modification report and these developments are summarised in section 1.2, 1.3 and 1.4.

The initial Proposal was: Transco will offer entry capacity for a period up to [13] years in advance of the time of use. Entry Capacity will be offered in segments of differing granularity. The purpose of this is to reduce complexity for longer term allocation (by only offering a high level of granularity) but to offer Users an increasing opportunity to fine tune their capacity requirements as a relevant gas day is approached. It is therefore proposed that capacity is offered at the following level of granularity:

Quarterly System Entry Capacity (QSEC) offered from year [4] to year [13];
Monthly System Entry Capacity (MSEC) offered from a month in advance of the relevant month up to and including year [3];
Daily System Entry Capacity (DSEC) offered from the day before through to 02:00 on a relevant gas day; and
Daily Interruptible System Entry Capacity (DISEC) offered on the day ahead of a relevant gas day.

All capacity will be offered on the basis of an end of day quantity from which is derived an equal hourly flow rate against which Users have purchased a right to flow gas. Payment, as now, will continue to be due the month after the month of potential use and will be charged on a pence per kWh basis. The payment liability will remain with the primary purchaser regardless of secondary market trading. This proposal

does not amend the existing mechanism for buy back cost apportionment, except to include QSEC holdings along with MSEC.

QSEC will be bundled into calendar quarters (starting with January to March) and capacity will be offered on the basis of an equal daily quantity for each day of the period. QSEC will be offered in an annual allocation which will take place in [July] of each year.

MSEC will be offered on the basis of an equal daily quantity for each day of the monthly block. 12-monthly blocks of capacity, for the period October through to September will be offered in an annual allocation which will take place in [July] of each year. In addition, within a year a rolling MSEC allocation may be held to offer capacity for use in the month following the month of allocation.

DSEC will be offered from the day ahead stage and during a relevant gas day. Capacity allocated within a gas day will be allocated on the basis of equal hourly use through to the end of the gas day.

Transco will offer a quantity that, in aggregate, is no less than the appropriate quantity of Baseline Capacity that is expected to be specified in its Gas Transporter Licence. The release will be structured so that 80% of Baseline Capacity will be offered initially in the most distant year for which capacity is made available. Thereafter in each annual allocation the residual quantity, taking into account previous allocations in the relevant year, will be made available for Users. In the annual MSEC allocation that is held immediately prior to the relevant gas year the quantity to be offered will be at least 20% of the appropriate Baseline Capacity plus any Entry Capacity remaining unsold from previous allocations. Within a relevant gas year any residual quantity of Baseline Capacity will be offered in a rolling MSEC allocation to be held prior to each relevant capacity month. Transco will be able to offer additional entry capacity (above the allocation requirement described above) in any allocation.

QSEC will be offered in a bid period of [5] business days. Transco will signal an initial cost associated with provision of quantities up to Baseline Capacity and it will also signal a series of [20] marginal costs which will broadly reflect costs that may be anticipated for providing an additional increment of marginal output above the preset output measure taking account of an appropriate return and recovery of costs over the full accounting life of the asset. Broadly it is expected that the increments should provide indicative costs for providing equal sized increments up to an aggregate quantity that is equal to [50]% of Baseline Capacity (i.e. the costs if capacity provision on an equivalent basis was to be increased [50]% above Baseline Capacity). Each cost calculated will be converted to an equivalent price and Users will be able to signal the volume that they might wish to acquire at each of the indicated prices.

When the bid period is completed Transco will aggregate the quantities demanded at each price to create a demand curve for each period in which demand has been placed. If aggregate demand is less than or equal to the relevant proportion of Baseline Capacity on offer at the initial price indicated, then all capacity demanded will be allocated and the initial price against which demand was placed will be payable for all units of capacity. If aggregate demand is greater than the relevant proportion of Baseline Capacity (or capacity remaining available after previous

allocations), then Transco will give consideration to the potential risks and rewards associated with the provision of additional increments of capacity above a relevant Baseline Capacity. Transco will determine the cleared price (which will be one of the published prices for each ASEP and capacity period combination) and volume to be allocated. If valid demand is equal to the volume available at the selected cleared price, then capacity will be allocated to all valid bids at that price. If demand exceeds supply at the cleared price, then Transco will allocate 100% of User's valid demand at the next price step that signals an aggregate demand that is less than supply. The remaining unallocated quantity is allocated in proportion to the extent of User's unsatisfied demand at the cleared price.

The process from bid window closure to publication of results will take up to 2-months.

MSEC will continue to be offered on an annual basis (years 1 to 3) in a pay-as-bid blind auction. The reduced quantities implied by a requirement to offer the majority of capacity in preceding (QSEC) allocations and the potential for Transco to expand supply indicate that a single round is appropriate and the final optimisation round will no longer be required. A release based upon the proposed Baseline Capacities removes any potential for significant inter-ASEP optimisation. It is proposed that the bid window periods remain unchanged and the reporting arrangements for reporting allocation results and statistics remain unchanged. The date at which an allocation can be completed and consequently the date at which accompanying statistics are produced will be 2-months after closure of the bid window. The delay is necessary to enable Transco to consider whether any additional capacity should be released and to carry out the necessary risk and reward analysis.

Within a gas year a rolling MSEC allocation may be conducted each month. The quantity to be offered would be any residual Baseline Capacity remaining unsold by Transco for use in the following month. The allocation process will be a single round blind pay-as-bid allocation. The reporting requirements will remain unchanged from those for the existing MSEC auctions. The allocation results will be published 3-business days after closure of the bid window. It is also proposed that the present "off the shelf" provision of MSEC is discontinued because a more frequent use of market based allocation processes should offer adequate opportunity for Users to obtain MSEC.

Overrun charges should be adapted to reflect the new entry capacity release process. It is proposed that the Overrun charge should be based on a multiple of the highest price paid for firm entry capacity and firm entry capacity management tools, where the multiples are [8] for all types of Firm Entry Capacity. In the case of capacity management tools, a multiplier of [1.1] is applied to the weighted average (by volume) of the top [25]% of accepted and exercised bids for each product.

Monthly Interruptible System Entry Capacity should not be required because the new arrangements will enable capacity provision to be expanded if appropriate.

It is also proposed that the requirement to release a daily estimate of use-it-or-lose-it capacity on an interruptible basis should be capped to maintain the release of this product in manageable proportions. Recent moves to a "top down" type entry capacity

arrangement have created difficulties in managing this product. With this in mind, it is proposed that DISEC capacity release on any day and at any ASEP should be capped at the greater of [100] GWh/day or [10%] of Baseline Capacity and that the scaling factors that may be necessary to manage this product should be proportionate to operational need.

1.2 Further Changes During Consultation Period

Following publication of the draft modification report, the Capacity Workstream continued to develop the Proposal, to include certain aspects of Modification Proposal 0508 and in response to Ofgem's proposed amendments to Transco's GT Licence.

- Capacity offered for 15 years, QSEC for years 3 to 15 and MSEC for years 1 and 2.
- Bid window extended to 10 days, with the possibility of early closure if the clearing price at all ASEPs for all quarters has not changed between closure on one day and the next.
- Users informed of quantities bid for at each price level for each ASEP and quarter at the end of each day in the bid window.
- Amount of capacity for sale amended to reflect Ofgem's proposed Licence Modifications, to be at least equal to the extent that Transco has not met its obligation to offer capacity for sale in a clearing allocation; this will include 20% of Baseline Capacity withheld until the annual MSEC auction before the year of use.

1.3 Supplementary Consultation - Limited Pro-rating

Transco issued a Supplementary Consultation on 2 July 2002, following Transco and Ofgem discussions and consideration in the Capacity Workstream, to consider an alternative allocation method. This revised mechanism would allocate capacity at the lowest price step at which demand is less than or equal to supply (as determined by the Incremental Entry Capacity Release Methodology (IECR)). All successful bidders would then be allocated the capacity they bid for and would pay the price for the step at which the allocation was carried out. In this approach if demand is less than supply then there remains an unallocated quantity that would be carried over to subsequent allocations (planned to occur on an annual basis). Pro-rating would only remain necessary if a step cannot be identified at which supply exceeds or is equal to demand.

1.4 Supplementary Consultation - Date Of Initial Long Term Auction

Transco issued a further Supplementary Consultation on 10 September 2002, following an open letter to the industry issued by Ofgem which discussed the starting date for long term auctions. In that consultation Transco proposed to amend its Final Modification Report such that the October 2002 date is amended to January 2003, implying that the first auctions of long-term entry capacity would be held in January 2003

2. Transco's Opinion

Transco supports the principle of making available longer term Entry Capacity rights. To achieve that objective, a robust product definition must be achieved and the long term allocation process must dovetail with shorter term release processes. This has necessitated a review of most of the existing aspects of Network Code section B2 in addition to the formulation of a new auction based allocation process. Transco believes that taken together with the proposed System Operator Incentives, implementation of the Proposal should better enable Transco and Users to contract for an efficient level of Entry Capacity.

The terms of reference for the Workstream set a number of objectives for the development of long term Entry Capacity amongst which were included: "so that efficient and timely investment can be undertaken" and that "capacity is placed where and when shippers want it". In order to fulfil these objectives, there was widespread, although not universal agreement that a quarterly capacity bundle would provide Users with an opportunity to inform Transco of seasonal requirements in addition to providing an indication of longer term demand. However, some parties argued that an annual capacity product should be offered. Transco considers that quarterly capacity potentially facilitates provision of a valuable signal about seasonal requirements that would not be available through an annual allocation. To that extent it believes a quarterly product will offer an opportunity for more efficient capacity provision.

Transco has indicated in the Workstream discussion that it would seek views on the appropriate number of marginal cost steps (20 are proposed) and the appropriate aggregate additional volume (provision of no less than 150% of Baseline Capacity is proposed). Transco believes that the marginal cost steps should be small enough to offer an opportunity for a close match between supply and demand and consequently will minimise the materiality of any pro rating rules.

Transco believes that competition between Users and efficient allocation may best be served by replacing the present off the shelf process with the proposed rolling MSEC allocation. This process will also provide an additional opportunity for Transco to respond to User demand for additional Entry Capacity.

The Workstream process originally identified a 5 day bid period for QSEC and a single bid day for MSEC, following additional discussions within the Workstream, this has been extended to 10 days, with the possibility of early closure if the clearing price is stable day-on-day. Transco believes that the increased number of opportunities to obtain Entry Capacity, through a series of annual and within year processes, will effectively provide a multi-round opportunity for Users to obtain capacity. In this context the quantities that may be demanded in any year may be comparatively small. Consequently Transco believes the bid periods indicated should be sufficient.

During the Workstream discussion there has been some debate about the need for an anti-hoarding product and the appropriate volumes that should be offered. The

original proposal maintains use of the present Daily Interruptible System Entry Capacity product as an anti-hoarding tool, but views were sought on the appropriateness of limiting the quantities to be made available. Transco proposed a maximum quantity that was the greater of 10% of baseline capacity or 100 GWh. In Transco's opinion, a release of a high level of Interruptible capacity could potentially lead to inefficient operation of the system and a high degree of uncertainty for Users about the extent of scale back. When taken together with the quantities of firm capacity released, it is clear that the aggregate quantity of Entry Capacity can be far in excess of physical capability. However, despite Transco concerns, Transco notes the value that Users attach to this service and has decided not to pursue this aspect of the proposal.

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

The proposed changes to the Entry Capacity regime are expected to better facilitate the following relevant objectives:

Condition 7(1)(a) - *"the efficient and economic operation by the licensee of its pipe-line system"* and

Condition 7(1)(c) - *"the securing of effective competition between relevant shippers and between relevant suppliers"*.

It should be noted that the proposal will also "fit" with the proposed System Operator Incentive which are expected to be introduced with effect from 1 April 2002.

The key features of the proposals that will help achieve these relevant objectives are as follows:

Long term capacity allocation will enable contracting for an efficient level of entry capacity that will satisfy Users needs and could be offered at prices that reflect Transco's costs. The process will also enable Users seasonal demand to be signalled in a manner that supplements the present planning process.

Effective competition is enhanced by offering long term Entry Capacity to all Users on a non-discriminatory basis and by utilising credit arrangements that maintain low barriers to entry.

The proposed allocation process will provide greater certainty and reduced risk for Users through a frequent (annual) offering of Entry Capacity that enables a User's capacity portfolio to be managed incrementally and for it to consist of capacity commitments for varying periods of time.

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

a) implications for the operation of the System:

It is not anticipated that daily operation of the system will be impacted by this development. In terms of the appropriate size of the system the signals received

from a long term allocation process might lead to a changed investment programme to more closely match Users' needs.

b) development and capital cost and operating cost implications:

Development costs will be incurred as a new computer system will be required to manage the allocation process. In addition billing systems will need to be adapted to provide functionality to reflect new charge types for entry capacity.

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:

No consequences are 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

No change in risk is anticipated as a result of introducing new capacity allocation procedures.

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

Systems developments will be required to implement this proposal, and it is anticipated that these will be delivered in time to hold the first long term auctions in 2002. Capacity registration and billing processes will remain largely unchanged though they must be adapted to reflect the introduction of new categories of capacity and release over extended durations.

7. The implications of implementing the Modification Proposal for Users

Users will have an opportunity to acquire entry capacity for periods of up to 13 years. Users will be able to hold a mix of long and short term capacity in a manner that reflects their risk profile. Users will also have opportunities to demand and receive capacity in excess of the Baseline Capacity expected to be identified in Transco's GT Licence.

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

A process that enables long term capacity to be allocated is expected to facilitate more efficient planning of gas supplies by producers.

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

Amendments to Transco's GT Licence have been proposed by Ofgem to introduce the System Operator Incentives that incentivise Transco to respond to long term investment signals. A greater use of incentives may change the relationship between Transco and each User, in particular where revenue share or over/under recovery arrangements are in place.

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

Advantages:

- Scope for improved signals regarding likely future demands for entry capacity;
- More opportunities for Users to obtain Entry Capacity; and
- Users can obtain a mix of short and long term Entry Capacity to reflect each User's capacity requirements.

Disadvantages:

- More complex systems are required to manage the Entry Capacity process; and
- Long term capacity release may create considerable inertia to change should refinements be necessary.

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

Transco received a total of 17 representations for this Proposal:-

British Gas Trading (BGT)
Innogy (Innogy)
Powergen (Powergen)
TXU Europe Energy (TXU)
Phillips Petroleum Company (PPC)
Conoco UK (Conoco)
TotalFinaElf Exploration UK (TFEexp)
TotalFinaElf Gas and Power (TFE)
BP Gas Marketing (BP)
Statoil UK (Statoil)
ExxonMobil Gas Marketing (ExxonMobil)
Chevrontexaco (CT)
Dynergy (Dynergy)

Scottish and Southern Energy (SSE)
Scottish Power (SP)
Shell Gas Direct (SGD)
BG Group (BGS)

Six respondents supported the proposal in the form presented (BGT, Powergen, Conoco, Dynegy, SSE, SP).

Three respondents did not express a definite opinion (BP, Statoil, CT).

Eight respondents did not support the proposal (Innogy, TXU, TFEexp, PPC, TFE, ExxonMobil, SGD, BGS).

11.1 Timetable, Licence & Supplementary Documents

SSE suggested “that more time needs to be allowed for information to be published ahead of the first long-term allocation to enable all parties to become fully cognisant of the nuances of the process”. SGD recommends that this proposal is only implemented following further consultation once all associated details are established and certainly no earlier than February 2003.

PPC believes "the current proposal for summer 2002, to have auctions in July and August does not allow sufficient focused time to prepare a bid strategy and obtain management approval for the August auctions". It proposes "that in the first instance the capacity for October 2004 onwards can be auctioned in any month during the 4th quarter of 2002 or even 1st quarter of 2003, to provide the whole industry with the necessary preparation time" and states it is "necessary to have at least 2 clear months between agreement of the regime and the start of the allocation process in order that companies can review their positions and understand the process at all levels".

TXU opposes implementation. Its “objection is not based upon the design of the long-term allocation process but upon its implementation timetable”. TXU “recognise that when the proposal was developed, it was anticipated that the new Price Control would be in place from 1 April 2002, this has not however proved to be the case”. TXU also considers “it is necessary to plan a gap of three months between completion of all the documentation and the start of the auction process”. Conoco, whilst supporting the proposal believes that “it would be prudent to defer for one year” to enable greater clarity of all supporting documentation including the GT Licence and supplementary documents.

Statoil is of the opinion that the “most important single source of uncertainty conditioning whether a decision can now be made about Modification Proposal 0500 is the interaction with Ofgem’s proposals for a modification of Transco’s Gas Transporters Licence”. The Licence consultation is not yet finalised and it is Statoil’s view “that there are sufficient material issues to warrant a re-consultation”.

ExxonMobil indicated it would expect Transco to re-consult once the legal text has been modified in line with the business rules and GT Licence. CT also believes that Transco should re-issue the Draft Modification Report to clarify the final proposal and argues that the timetable targeting August implementation is “unrealistic” because long-term capacity “is too important to be rushed”.

Several respondents (BGT, BP, Dynegy, SSE, Statoil, TXU) consider it is impossible to obtain a realistic assessment of Transco’s obligations until the final version of the Licence, including the content of the System Management Principles, Procurement Guidelines and Incremental Entry Capacity Release Statement (IECR), are available. They believe that the industry needs to fully consider all the implications prior to committing to a process, which has significant operational and commercial impacts for Users. TXU is “not confident that the business rules and the legal drafting will properly reflect the Licence obligations” and consequently does not feel able to “provide full and detailed representations” prior to completion of the Licence consultation.

TFEexp and TFE take the view that preparation, by Transco, of the IECR methodology statement is a vital element in giving clarity on the issue of whether Transco will have an obligation to allocate capacity if the conditions of the IECR are met. ExxonMobil wish “to reserve the right to revert to Transco with revised comments regarding Modification Proposal 0500 if, following finalisation of the IECR statement, the statement is not, in its opinion, consistent with a process that results in Transco allocating incremental capacity on an efficient basis and in a timely manner”. Dynegy believes “market participants need to be aware of the methodology that shall determine the volumes of incremental capacity available, before the long-term entry capacity bidding strategy begins”. SSE expressed concern that there is a “lack of clarity about the way Transco will accept bids and allocate long-term capacity after the bidding period has finished”.

SSE stated that “shippers and Modification Panel members have expressed grave concerns about the way in which this proposal has been conducted....without a clear understanding of the regulatory regime to be contained in the GT Licence”. It is “alarmed that a decision could be made to implement the proposal before the GT Licence and supporting documents are finalised”. SSE urge Transco and Ofgem to take into account the “industry view that the consultation on this proposal should be reopened once the Licence modifications and other documents relating to the new price control and the SO incentive have been consulted upon and agreed”. BGS commented that "until the issue of Transco’s Licence has been fully and finally resolved, shippers will not be in a position to value accurately the risks facing them when making potentially long term commitments for entry capacity. BGS believe that Ofgem will need to re-consult and "do not support Long Term Entry Capacity auctions being held prior to 1/10/02, or indeed during 2002".

Transco response

Transco sympathises with respondents view that, there has been uncertainty concerning regime changes for entry capacity, including Ofgem’s proposed changes to Transco’s GT Licence. Transco has tried to ensure as much

information as possible is available to Users. In light of the uncertainties, Transco considers that it would be appropriate to delay the first long-term auction (in respect of capacity for October 2004 onwards) until October with the first RMSEC auction to be held towards the end of September (in respect of October 2002 capacity).

The timetable would be as follows:

Quantities published	early September 2002
IECR implemented	early September 2002
(note: IECR is expected to include detail of price steps)	
RMSEC	last week in September 2002
LTSEC bidding	completed by 31 October 2002
LTSEC allocations published	by 31 December 2002
MSEC for 12 months Oct 03-Sep 04	by end Aug 03

Transco recognises the concerns expressed by a number of respondents about the time needed to prepare bidding strategies. However, delay of the first LTSEC auctions would mean loss of an opportunity to incorporate the information revealed by these auctions in Transco's investment plans. In addition Transco notes that the Licence obligations proposed by Ofgem suggest that "the licensee shall use all reasonable endeavours to ensure that by 1 November 2002 it has offered for sale all long-term baseline entry capacity available in respect of at least formula years 1 to 5 inclusive...". Transco therefore continues to believe that it is appropriate to hold the first LTSEC auctions as early as possible. This does not, however, preclude the possibility of a second auction being held relatively early in 2003, consistent with the views of a number of respondents.

11.2 Capacity Quantities

BGT welcomes the “adoption of the principle of “Top-down” quantities of capacity being made available” and recognises that overselling capacity necessitates the capacity management arrangements and selling process described. With a top-down release of capacity, Innogy “agree that there may be a case for limiting the volume of DISEC made available”. However BGS is concerned that “the top-down model fails to provide the necessary investment signals to enhance the UK’s future security of supply”.

SSE considers that “there should be a clear and transparent process for releasing details of the volumes of entry capacity that Transco offers for sale, both in the short and in the long term”. In part, it thinks “that this will be determined by the SO incentive framework set out in the GT Licence” and SSE understands “that Transco envisages publishing this information in its transportation statement”. However, SSE is “unclear whether the Licence will specify when the information is to be released”. Dynegy observed that there has been “no publication of the transportation statement, thus creating a lack of transparency within the entry capacity market”.

Transco response

In the initial LTSEC auction, Transco expects at minimum to accept all valid bids for capacity up to the level of long-term NTS SO baseline entry capacity as defined in Ofgem's proposed amendments to Transco's GT Licence (i.e. 80% of the SO Baseline Entry Capacity quantities in Table A2 of Ofgem's proposed amendments to Transco's GT Licence). Transco anticipates publishing a revised Transportation Statement at least 28 days before any auction, as specified in the Modification Proposal.

11.3 Hybrid Model

BGT wished to acknowledge the work carried out by TotalFinaElf "in raising and developing the alternate modification proposal 0508, elements of which have subsequently been assimilated into the revised modification proposal 0500". TFEexp and SGD also welcome many of the recent amendments made by Transco to Modification Proposal 0500.

Statoil expressed concern that a material adaptation of Modification Proposal 0500 has been suggested without being clearly brought forward and defined in the form of a separate Modification Proposal. As a matter of principle and good practice, Statoil stated it would not wish to see future significant Network Code modifications subject to similar adaptation.

Innogy and Powergen indicated that in general they support greater transparency and improved price discovery that is available through the later developments of this proposal. Innogy is "concerned about the [precise formulation of the closure mechanism and it needs to avoid penalising bidders that alter bids between rounds but whose volumes may not be large enough to change the clearing price levels](#)". Innogy argues that with increased information release during the allocation there is always room for gaming, but on balance the Innogy preference is for greater transparency. Powergen commented that "[an iterative process to support price discovery...does lead to better price transparency, but this has to be weighed against the extra complexity this method entails](#)". ExxonMobil agrees that the allocation process should be iterative, "allowing shippers to adjust their bids at different entry points and across strips in response to prices emerging through a bidding process".

SSE sought "[clarification as to whether these criteria must be satisfied at all ASEPs, or whether each individual ASEP is assessed on this basis](#)".

In order to avoid confusion BP and SGD believe that a separate consultation should be undertaken on the enhanced proposal. BP is however concerned that "a desire for further consultation is not interpreted as a lack of support for a volume based auction", "which for the avoidance of doubt it believes is best suited to deliver cost reflective prices to the industry and customers, and will be less susceptible to prices driven by sentiment than a 'pay-as-bid' model". BP believes that an iterative process is "more desirable than the previous single round process because it offers bidders the chance to revise their volume bids, having viewed feedback from previous bidding".

Transco Response

Transco notes the level of support for a hybrid auction model.

Potential gaming is necessarily an issue in auction design, but Transco expects the publication of an end of day snapshot rather than real time data to have the effect of reducing gaming opportunities. If inappropriate behaviours are revealed, that could be an issue for Ofgem's consideration.

Transco would like to clarify that the proposed closure rules would only apply when the clearing price has stabilised at all ASEPs for all periods.

11.4 Withholding of Baseline Capacity

BGT expressed a "concern about the quantity of Baseline Capacity to be withheld from the Long Term allocation process". It accepts "the withholding of a quantity of Entry Capacity may facilitate a purchase from the primary seller for new entrants until a secondary market has established", but BGT "are of the view that the restriction of such a large quantity (20%) will confuse any investment signals in addition to inhibiting the development of a secondary market. The quantities of "new gas", as distinct from new players, is likely to be much more modest!" BGT welcomes the expectation of "a review of Ofgem's opinion on this point after two years although this potential for revision of the basis of allocation itself undermines the long term process". ExxonMobil, BG, Conoco and BP also considered that withholding capacity could undermine the process and ExxonMobil argued that inefficiencies would necessarily arise because Transco must take a view about how much of the withheld capacity will actually be bought by shippers. However, Innogy argued that holding back capacity would provide certainty for market participants that may be "unwilling or unable to commit to capacity long-term", although it recognises "that this dilutes any investment signal from the long-term allocation and may limit the development of secondary trading". Powergen thought that 20% should be held back "until a fully functioning secondary market is established" and SSE agreed that not to hold back 20% "would foreclose the market and create a barrier to entry for new entrants and those shippers unable to commit to purchasing long-term entry capacity, whilst favouring incumbent players".

Statoil expressed concern that there is "uncertainty at this stage about how requirements to hold back capacity will be ended within the two-year timescale outlined by Ofgem. In addition the criteria associated with a decision to end this withholding are unclear. The potential dynamic effects of this on a long-term auction have not been properly discussed or understood".

Transco Response

Transco expects the minimum quantities of capacity it must make available for sale to be specified in its GT Licence. Concerns about the definition of this quantity are, therefore, a matter for Ofgem to consider in light of responses to its consultation on proposed amendments to Transco's GT Licence.

11.5 Allocation Methodology

SSE indicated that it “has never supported the use of auction mechanisms to allocate entry capacity” and that it believes “that auctions have had a profound effect on supply competition”. SSE consider that auctions “have introduced a considerable amount of unnecessary risk into the capacity regime and have resulted in transportation charges that are no longer stable and predictable”. Notwithstanding this, SSE believes that “the proposal is preferable to the extension of the current price-based auction”.

Innogy observed that “market participants will generally have a shorter investment time horizon than the monopoly asset owner”. It believes that “coupled with concerns about regulatory risk and uncertainty about the definition and durability of capacity rights...the long-term auctions will clear at LRMC, suggesting demand will be no greater than current supply”. Innogy consider this “outcome could be achieved through non-discriminatory, bilateral contracts thereby avoiding the need for complicated auction design and revenue treatment arrangements”.

Innogy also believes that the “use of auctions in a price controlled environment inevitably generates differences between actual and allowed revenue” and the “mechanisms to deal with the any under or over-recovery inevitably lead to unwelcome distributive effects either between classes of system user or between current and future system users”. It therefore considers “any allocation mechanism should be designed to minimise the risk of over or under-recovery”.

BP “strongly favour a volume bid based process”, which it believes “will provide more cost reflective charges (and probably lower ones) than a ‘pay as bid’ solution that is likely to be driven by sentiment and perceived constraints and will thus be more volatile and less predictable”. ExxonMobil expressed support for a process that required “shippers to tender their volume requirements against known prices” and which would result in “all shippers paying the same price for the same product”.

PPC supports the development of an allocation methodology where "entry capacity can be bought at prices related to the cost of providing capacity", Users have "the opportunity to signal requirements for greater capacity than that currently available" and Users have a "strong certainty of acquiring their physical capacity requirements".

Transco Response

Transco agrees that it is possible that the auctions will clear at the lowest price step at many ASEPs in many periods, and that auction based income is inevitably likely to be inconsistent with allowed revenue limits set in its GT Licence.

11.6 Baseline Capacity Price & Price Steps

Innogy believes that “the allocation process should seek to minimise the risk of over or under-recovery of allowed revenues, as mechanisms to deal with the

under over-recovery inevitably lead to unwelcome distributive effects either between classes of system user or between current and future system users". On this basis, Innogy supports "an approach based on averaging incremental investment costs and using a cleared price, rather than pay as bid and marginal price". It does, however, "recognise that this may lead to sub-optimal investments but believe this potential inefficiency is preferable to dealing with over or under recoveries".

BP supports LRMC based funding of incremental capacity.

Statoil expressed concern that "the pricing methodology for capacity allocation is unclear – particularly the level of reserve prices required for the auctioning of initial baseline capacity" and "how and when Transco might reduce any reserve prices to zero at the day ahead stage to meet the proposed Licence requirement on a clearing allocation of initial baseline capacity".

ExxonMobil noted that there is "an inconsistency in version 0.6 of the business rule between section 5.2 (which refers to 'up to [150%] of Baseline Capacity') and section 7.5 (which refers to 'at least [50%] of Baseline Capacity')". ExxonMobil and SSE believe that the 20 marginal cost steps should, in aggregate total at least 50% of Baseline Capacity. CT and SGD agree that 20 steps are appropriate. "SSE queries whether 28 days before the first annual bid process is enough time for Transco to release information about incremental average/marginal costs". "SSE assumes that it can expect a pricing methodology consultation that will set out how the average or marginal increments are to be determined. Similarly, it would expect Transco to consult on how and when it will apply reserve prices for the sale of short-term capacity through a price based auction".

Transco Response

Transco expects that the price steps, and the approach to their calculation, will be specified in the IECR envisaged by Ofgem's proposed amendments to Transco's GT Licence. Transco anticipates that the price steps will reflect estimated long run marginal costs.

Transco notes the support shown by Users for 20 steps and proposes to proceed on this basis.

Transco notes Exxon Mobil's comment on the business rules and can confirm that Section 5.2 should say "at least 150% of baseline"; this has been reflected in the legal drafting.

11.7 Automatic Allocation & IECR

TFE and TFEexp argue that if pre-set conditions to be identified in an IECR are met, then Transco should be obligated to allocate capacity without reference to any other body.

ExxonMobil believes Transco should be able to “utilise these signals [from the auction], in conjunction with supply and demand forecasts developed from data received from other sources, and then interpret all available information and make timely and efficient investment decisions that are in the best interests of the UK gas industry”.

BP believes “that the publication of the IECR statement is essential in order to facilitate a full understanding of the modification proposal's implications. BP believes that without this, thorough consultation responses cannot be submitted by the industry. The contents of the IECR statement and the timing of any change to it are critical as they may well impact a user's entry capacity bidding strategy”. Statoil considers that the effectiveness of any long-term allocation will depend critically on the content and application of the proposed IECR, which has not yet been discussed in detail. Statoil also observes that an allocation will be based on consideration of the provisions of the IECR statement rather than an automatic matching of supply and demand in the bid process. It considers that this is an important point of detail, which should be properly clarified and discussed before any long-term auction is held.

BP also believes “that it is essential that there are appropriate incentives to ensure that appropriate amounts of requested capacity are built, so that sufficient gas can be physically landed ensuring that supplies to UK customers are secure” and it is “not convinced that appropriate measures are proposed to provide this security”.

Concerning the IECR, PPC considered that "costs for investment and the prices in each price increment that need to be published 28 days prior to the auction, will be included in this statement. The prices must be not only transparent but also accurate. They should be based on sound premises not high-level guesstimates. The escalators for investment costs should also be discussed".

Transco Response.

Although not part of this Modification Proposal, Transco welcomes the comments on the proposed IECR. Transco has issued a draft IECR and views have been sought from Users. Transco anticipates that a final version could be implemented in early September, dependent on implementation of Ofgem's proposed amendments to Transco's GT Licence.

Transco believes that a key objective in developing long term auctions is to facilitate discovery of reliable investment signals. In this context, therefore, Transco has proposed an auction design which enables Users to reveal their capacity requirements at a number of price levels. It is not clear to Transco why individual User's underlying willingness to pay for capacity would necessarily be affected by the contents of the proposed IECR.

11.8 Granularity & Auction Period

Thirteen respondents (PPC, BGT, Conoco, CT, SSE, SGD, Powergen, Dynegy, SP, BP, Innogy, ExxonMobil and TXU) indicated support for a quarterly product. Innogy and BP argued that a quarterly product would provide more

information about peak requirements and thereby give a better investment signal. Innogy also considered that “in the absence of a liquid secondary market, shippers that have a profiled gas requirement are unlikely to be willing to book peak requirements for 12-months”. However, Statoil believes that an annual or six monthly product would better facilitate ‘unbundling’ and hence trading of capacity in the market place. SP did express concern that “the quarterly periods proposed are most appropriate in terms of efficient allocation, since they don’t exactly conform to the periods of seasonality within the gas industry”.

Nine respondents (BGT, Powergen, Innogy, TFEexp, Conoco, SSE, BP, ExxonMobil and TXU) supported the sale of capacity for the period year 3 to year 15 inclusive. CT indicated it “is indifferent to whether a 13 or 15 year product should be offered”, however it believes “that allocations should be made for year 3 onwards, in order that Transco can start to make necessary NTS investments in a timely manner”. SP indicated that it would be opposed to any period over 15 years because it could “provide significant competitive advantage to certain sectors of the community able to secure longer-term beach access”. PPC does not support capacity sales for a 13 year duration, and proposed that the duration should be limited to 5 years, because it “is unlikely that baseline capacity will be sold out further than in the near term and only at competitive ASEPs”, “the UKCS is a mature area and the gas fields have quickly declining profiles; this creates longer-term uncertainty due to reservoir performance” and “changes in regulatory regime with new price controls could affect the capacity already purchased”

Transco Response

Transco notes the level of support for this aspect of the proposal and agrees that an auction based on quarterly units of capacity for years 3 to 15 offers an opportunity for Transco to receive seasonal signals in respect of User's capacity requirements.

11.9 Closure Timescale & Mechanism

Conoco, Dynegy, CT and ExxonMobil all indicate support for a 10 day auction window. However, Powergen expressed a preference for a five day auction. SSE argue that the “allocation will be most efficient if shippers have sufficient time to digest and respond to the price and volume signals”. It therefore suggests that if there are to be five bidding days, there “ought to be at least one ‘rest’ day between each bidding day to enable shippers to switch demand between locations or adjust demands individually”.

For both Modification Proposal 0500 and 0508 Statoil “does not believe that discussions have yet shown sufficient clarity about the effectiveness of the close-out procedures for each proposed model and how useful they would be in preventing potential gaming”.

BGT and TFEexp support the view expressed within the Workstream that the feedback from the process needs to be available as soon as possible after the process has completed. BGT understands “that the IECR is likely to require an

audit of the rationale followed in allocating incremental capacity, it is not acceptable for Users to wait two months for the certainty that capacity has been obtained". BGT is also concerned that "this term is also included within the process for annual MSEC auctions with a 1 month delay before allocation" and it considers this to be "an unacceptable delay for no apparent reason". Dynegy believes "this time period is excessive and would create uncertainty in the market" and argues that "market participants maybe reluctant to actively participate due to the uncertainty of whether they have been successful or unsuccessful regarding their bidding strategy".

Transco Response

Transco notes the level of support for the extension of the auction window from 5 to 10 days and in conjunction with the proposed closure rules believes that the proposal provides an appropriate compromise opportunity for Users to refine their bids without placing an inappropriate burden on Users to rapidly refine their positions in the light of emerging signals. However a day between each bid window would expand the auction process to one month, which Transco would not support.

Transco and Users have been in discussion regarding the close out procedures for a considerable time. Laboratory tests have been carried out and the methodology has been adjusted in light of knowledge gained. Transco recognise that the close out process could evolve further in light of future experiences and subject to an appropriate Network Code Modification Proposal being raised.

Transco sympathises with Users' desire to have information as soon as possible after the auction window closes. Transco plans to publish information as soon as it is able to, but the time required is uncertain, and hence an extended time period for allocation has been included in the business rules. Transco will need to analyse the bids received, reach views on the capacity offers to accept, seek internal approval for any associated expenditure and, in accordance with the proposed Licence conditions (should they be implemented) seek Ofgem's approval through the IECR process, including commissioning an audit of its application of the IECR.

11.10 Minimum Capacity Amount

TXU observed that the present drafting "restricts Users to bidding for a minimum amount of 100,000 kWh for Entry capacity". A side effect of this requirement is "to restrict Transco's ability to allocate, e.g. if 500,000 kWh was available, but six shippers had all bid an equal price, Transco would be unable to allocate the capacity due to the minimum bid size of 100,000 kWh per shipper".

Transco Response

Transco considers that this may have been a significant issue under the original proposal, but given the changes proposed to the allocation methodology following the Supplementary Consultation (section 11.23), and the very limited use, if any, of pro-rating, this is likely have far more limited impact. therefore, at

this late stage of system development and to maintain consistency of approach between auction types, Transco does not believe it would be appropriate to make this change.

11.12 Information Provision during the Auction Window

Statoil suggests that more “work is necessary to clarify and refine issues related to the information to be provided to the market during an auction period and whether the auction process can in consequence be truly iterative or not”. Statoil considers that the “effectiveness of information provision and iteration will condition the practicality of a mechanism’s close-out procedure and proof against possible gaming”. SSE “welcomes the concept that a snapshot of bids should be published at the end of each day”.

Transco Response

Transco accepts that careful consideration is needed in respect of information provision during the bid window. If information is published in real time, significant gaming opportunities could be created and such an approach could impose an unacceptable risk to Users in respect of bid amendment close to the end of the bid window. Transco believes that a compromise has been reached to publish an occasional snapshot, and this will facilitate the market in efficiently adjusting bids. However, bidders cannot be certain to what extent competitors will amend their bids, and hence potential gaming is limited. Transco would expect to provide bid data to Ofgem should Ofgem conclude that was necessary to facilitate its market monitoring role.

11.13 Annual MSEC

Conoco favour maintaining the present four business day period for the annual allocation of MSEC, at least for an initial period, rather than the single day as proposed. CT “would prefer that MSEC auctions be spread over at least two rounds - buyers who missed out on QSEC (e.g. new market entrants, those who were unsuccessful) will be under immense pressure to succeed in a single MSEC round, which would drive them to pay high prices for capacity”. PPC expressed similar views to CT.

SSE would like clarification on “when it is proposed that a single day bid period for MSEC would be introduced”. SSE assumes that “MSEC auctions would not be restricted to a single day until the allocation when 20% residual capacity is offered”.

Transco Response

Transco recognises User’s concerns and proposed that capacity be offered in four rounds in Modification Proposal 0549. Transco anticipated that the initial release of capacity for 2003/04 would be over four rounds. This has since been amended by Modification Proposal 0564 to two 6 month blocks of capacity, both of which are to be offered over four rounds. Transco anticipates that the 12 months of capacity for gas year commencing October 2003 will be offered over four rounds

before the end of August 2003. Thereafter it is anticipated that a much smaller quantity of capacity will be offered for sale in annual MSEC auctions and a single round would be appropriate.

11.14 Rolling MSEC

Conoco, SGD, SP, BGT and ExxonMobil support the introduction of a Rolling MSEC (RMSEC) auction. However BGT considers that it should be held “as close as is practically possible to the end of the preceding month”. Innogy argues that a RMSEC process “coupled with DSEC will help to ensure that all baseline capacity is released”. TXU is “unsure because the new and old methods both have advantages, but believes that a rolling MSEC might place a greater administrative burden on shippers”. CT has no opinion. SSE does not support the rolling MSEC process as it believes it restricts Users ability to purchase MSEC compared with the current process where Users are “able to buy it on any day between the completion of the auctions and three days before the start of the relevant month”.

Transco Response

Transco notes the level of support for this aspect of the proposal and will progress its development. The RMSEC auctions would occur within five business days of the end of each month.

11.15 Buy-back liability

Innogy believes “that the long-term product should not have any buy-back liability associated with it as this weakens incentives on Transco and makes the valuation of the product more uncertain. Where there are shared buy-back liabilities, these may be subsumed into the SO commodity charge”.

BP “believes that Transco should have 100% liability for buyback costs (proposed in 508, but not in 500) to incentivise them to actually build physical capacity. BP believes it is essential that appropriate amounts of signalled incremental capacity be built in order to safeguard the physical supply of gas to UK customers”.

SSE sought clarification of how a User’s capacity would be treated in the event that the capacity is traded on to another party. It understands “that the proposal is that all liabilities associated with the product will transfer on a trade to the new owner even though the obligation to pay Transco will remain”. SSE considers that “this suggests Transco would need to track entry capacity trades on the secondary market for billing purposes and to ensure that liabilities are correctly assigned”. SSE also queries “whether a User would be able to assign, as opposed to trade a capacity holding to another party”.

Transco Response

Transco believes that any proposals to substantially change the present capacity neutrality arrangements should be the subject of a separate Network Code Modification Proposal.

Ofgem has proposed and consulted on parameters for a buy-back incentive scheme, and these fall outside the remit of this Modification Proposal.

Many of the issues raised by SSE were covered in Modification Proposal 0559., This has now been implemented, and the Network Code provides for Users' liabilities to vary as they buy and sell firm capacity.

11.16 Cancellation of Firm Capacity

BGT, Conoco, BP, SGD, Statoil, Dynegy, ExxonMobil, TFE and TFEexp register strong opposition to the term, currently in the Business Rules (1.9) and legal drafting (2.1.13), which BGT considers "appears to allow Transco to re-possess Capacity which they have previously committed to in the event of some statutory change". BGT argues "Transco cannot seek to protect themselves from this type of uncertainty by passing the exposure to Users". TXU also opposes the clause because it feels that "a clause such as this with no safeguards changes the balance of risk to an unacceptable degree". It argues that a "more usual contractual provision would be for the parties to undertake to meet to try to resolve such issues equitably, on a good faith basis". Subject to the detail of the drafting, TXU would be prepared to support a clause of this type. PPC considers this clause is not "conducive to providing shippers with any certainty regarding the capacity product they may purchase" and proposes its removal together with a limit on the duration of capacity sales to five years. Dynegy would like clarification upon why a notice period of three years has been established as a reasonable notification time frame.

Transco Response

Transco believes that there is a clear risk of substantial regime change within a medium term time frame. For example, changes could come from Europe (e.g. competition law), domestic legislation (e.g. security of supply) or new regulatory goals (e.g. gas balancing). Transco considers that efficient regime change can be hindered by substantial legacy contracts. Nevertheless, Transco understands the concerns of its customers and the proposal was written with clear safeguards such that implementation of the provision would not be Transco's decision and would contain a substantial notice period. Ofgem has subsequently indicated to Transco that it does not believe the clause is necessary since existing provisions already allow for this outcome in appropriate circumstances; that Ofgem would not wish to have a Network Code derived power to decide it was appropriate to cancel firm capacity; and that it does not believe the proposal is consistent with furthering the relevant objectives. Given Ofgem's indication that it would not be able to implement this Modification Proposal were this aspect included in the final legal text, Transco has withdrawn this aspect from the final proposal. This will enable Ofgem to consider whether or not it believes the remainder of the proposal furthers the relevant objectives and hence should, or should not, be implemented.

11.17 Credit Arrangements

Statoil observed that “credit arrangements will be of great importance to the success of any long term capacity allocation in view of the large sums of money market participants will prospectively be committing”. Statoil notes “that Ofgem have recently held a consultation on future credit arrangements”. Statoil argues that any changes that may result from that consultation will “be a material factor [when] considering which of the proposals under consultation might work best”.

Innogy argues that the proposal to “evaluate creditworthiness immediately before the year of gas flow against the capacity places low barriers on participating in the allocations but exposes System Users to considerable risk in the case of recall. In the absence of stringent credit arrangements, Innogy believe that Transco should not be held whole when selling recalled capacity. Transco should be incentivised to actively manage the exposure by facing a share of any costs”.

SSE wishes “to clarify what happens to a User’s long or short-term capacity holding if it fails. Would it be correct to assume that the arrangements introduced via modification 0509 would apply?”

ExxonMobil believes that “credit arrangements should be in place to ensure that shippers are not exposed to the costs of another shipper defaulting on financial commitments associated with long-term capacity”. ExxonMobil argues that “these arrangements should reflect the credit rating of the shipper, or its parent company where appropriate, and should involve cash (held in a reserve account by Transco) or Letters of Credit. A Parent Company Guarantee or other form of guarantee should only be retained where the Approved Credit Rating of the shipper, or its parent company, is above the typical level of banks providing Letters of Credit for the same sector”.

PPC is concerned that the credit arrangements described in the business rules do not “provide sufficient protection to the shipper community if one party quickly lost its creditworthiness”. It recognises “that much research into credit arrangements has been carried out”, but believes “there should be a mechanism to review and update the credit rating of each shipper more frequently than once a year”.

Transco Response

Transco agrees that credit arrangements can have a significant impact on the outcome of any long term auction process. Transco has tried to strike a balance between credit arrangements that create prohibitive cost for some who may otherwise wish to take part in LTSEC auctions, and weak arrangements that enable any costs of failure to be passed on to other Users. Transco believes that a 12-month capacity credit requirement is the maximum term of credit guarantee that can be obtained without recourse to bespoke (therefore expensive) products. Transco believes that the principles associated with the processes defined in Modification Proposal 0509 would apply, whereby if a User is terminated their capacity would be released for sale in subsequent auctions to other parties

(except where it has been traded to another User). In addition, Ofgem has proposed a Licence condition that would require Transco to offer any recalled capacity for sale in subsequent auctions.

Transco has considered parent company guarantees and discussed this in Workstream meetings. The value of such guarantees can change dramatically as recent history has demonstrated. Transco sympathises with the view expressed by respondents in respect of the form and nature of credit. However, it is mindful that any approach must be not unduly discriminatory.

11.18 Interruptible Capacity

Two Users (ExxonMobil, SP) expressed support for the proposal to limit Daily Interruptible System Entry Capacity (DISEC) to the greater of 10% of the relevant Baseline Capacity or 100 GWh. ExxonMobil agrees that “these quantities strike the right balance between overcoming hoarding concerns and enabling Transco to efficiently manage capacity released in a more structured manner”. SGD supports “the idea of setting a threshold for the amount of DISEC” but believes “further discussion is required on whether 10% of the relevant Baseline Capacity for each ASEP is appropriate”. CT is not in favour of restricting availability in the manner proposed.

PPC support the retention of use-it-or-lose-it arrangements to "[help dissuade parties from purchasing too much speculative capacity and therefore distorting the investment signal](#)".

SSE does not believe that “the interruptible product should be removed until a liquid secondary market has been established”.

Transco Response.

Transco agrees that an anti-hoarding mechanism may be justified. However, given that Baseline Capacity is generally greater than physical capability, the requirement for an anti-hoarding mechanism is reduced. If large quantities of interruptible capacity are released, it becomes difficult to manage both from a User and Transco perspective, and hence Transco’s proposal. However, Transco recognises the widespread community and Ofgem support for the continued release of potentially high quantities of interruptible capacity and so this aspect of the proposal will be withdrawn. Transco anticipates reconsidering this in the light of experience and, if appropriate, raising a further Network Code Modification Proposal to refine the arrangements.

11.19 Section I

SSE believes that this “methodology should be revisited once the entry regime has been finalised”. SSE believes that “the section I methodology should be broadly equivalent to the determination of overrun charges”.

Transco Response

Transco believes that Section I liabilities as they currently stand are appropriate and should not be amended to be similar to overrun charges, as Section I is intended to incentivise Transco to buy-back capacity when necessary or to bear costs in excess those associated with taking an action in a timely manner. Where there were no buy-back bids available (i.e. market failure), then the price is based on that paid by Users for MSEC. The only change proposed as part of Modification Proposal 0500 is to include QSEC in the latter calculation, as without it the liabilities would be deficient.

11.20 Maintenance

Dynegy does not agree with the proposal that the provision of maintenance information should be delayed until after completion of a primary auction. It argues that “the provision of the maintenance plan is vital information to market participants’ bidding strategy and Transco’s failure to release information looks like a serious abuse of market power, as it will be participating in the buy back market”. Dynegy comments “maintenance schedules must be published prior to the auctions and updated whenever they are altered”.

Transco Response

Transco believes that it is inappropriate to have to publish the maintenance schedule prior to an auction. Transco explained its reasons for not releasing such information in its report on Modification Proposal 0560.

To summarise Transco’s position :

- Information provision should be subject to a wider debate about the range of information that should be furnished by all parties to best enable efficient operation of the market,
- Transco believes that an intent of the incentive arrangements proposed by Ofgem is to encourage Transco to adopt a flexible approach to scheduling maintenance,
- Transco considers that in addition to being of diminished value, publication could potentially be positively misleading for Users as a consequence of uncertainties about the maintenance programme,
- Transco should not be required to publish commercially sensitive information regarding its future maintenance plans; and
- Transco observes that Ofgem has proposed that Transco should be obliged to offer firm Entry Capacity up to published baseline quantities. Users that purchase firm entry capacity have a right to nominate and flow gas up to the quantities of firm capacity that they have purchased. These quantities would not be affected by maintenance. Knowledge of actual physical capability is generally not available to Users and therefore it is not clear why specific information should be made available in respect of maintenance. It is not clear why this should affect the value placed on capacity by Users.

Transco nonetheless considers it appropriate to amend the proposed legal text to reflect the Modification Proposal 0560 decision.

11.21 Overrun Charges

SSE “disagrees with the proposal to amend the overrun charge methodology”. SSE recommends “that the derivation of the charge should be considered once the release processes have been finalised”. SSE believes, in principle, “that overrun charges should be cost reflective”.

PPC considers that overrun charges should "be reviewed in the light of any changes to the gas balancing regime".

Transco Response

Transco believes that it is necessary for the overrun charge to reflect all types of capacity product including QSEC, Forwards and Options. Transco has not tried to significantly adjust the level of charges, but rather to extend the scope of the calculation so that it reflects the prices associated with all forms of capacity and capacity management tools. A review of overrun charges as suggested by the respondents can be conducted through the usual channels.

11.22 Computer Systems

Two shippers (SSE, BP) raised concerns regarding the computer systems solutions that Transco need to have in place to ensure the successful implementation of the process. SSE comments “that the computer systems to support this proposal will not be delivered for August 2002, as Transco will not have been able to develop them without being certain of the outcome of the process”. SSE “advocates the design and testing of systems with shippers or even a practice dry run”. BP believes that “Unless it can be clearly shown that a robust solution can be delivered, we believe that the commencement of long-term entry capacity allocation should be delayed.”

Transco Response

Transco has been designing computer systems to meet the requirements of Modification Proposal 0500 and is confident these can be delivered and tested in time to support LTSEC auctions in October 2002. Other auctions can be run on the existing RGTA system using the current auction types.

11.23 Supplementary Consultation - Limited Pro-rating

Seven responses were received to the Supplementary Consultation. Of these, one (Statoil), indicated support for the revised proposal, five (BGT, SGD, TXU, TFEexp and PPC) did not support the revised proposal and one (SSE) did not express a definitive opinion.

SSE observed that this consultation demonstrates “its long held view that adequate time must be spent getting the long-term entry capacity allocation regime right; otherwise all market participants would be exposed to unacceptable risk”.

Statoil supports the proposal and believe that the methodology “set out should avoid any distortion of bidding and therefore create a clearer assessment of demand for capacity for Transco than the present rules may provide”.

SGD “do not consider that the alternative proposal is an improvement on the current drafting of Modification Proposal 0500”. It has concluded that “there may be one or two players who will consider overstatement to have beneficial effects but it is highly unlikely that there will be significant escalation of demand”. SGD believes “overstating demand has a significant potential downside risk attached to it” because the “allocation process could close out at the next step with the shipper left with more capacity than required which must be paid for or traded onwards with no guarantee of profit.”

TFE believes that “the pro-rata methodology is very unlikely to distort bidding behaviour because the outcomes are not predictable and trying to take advantage of the pro-rata methodology should thus be very hazardous”. TFE concludes that “it does not see any real problem with the pro-rata methodology”. It believes that the revised proposal would be acceptable “if unsold capacity is made available at a later date and if the price paid for capacity is the cost reflective price increment corresponding to the quantity of incremental capacity released”.

BGT is “concerned that the Supplementary Consultation proposes to alter the fundamentals on which the Long Term Capacity Allocation regime is to be based. It believes that it is not appropriate to substantially alter such fundamentals at this late stage in the regime’s development”.

BGT is also “concerned that amending the proposed allocation process will unnecessarily escalate the prices that shippers pay for entry capacity because Transco will have the ability to increase the cleared price for a minimal level of demand (e.g. 1 kWh over the threshold)”. It observes that any price increases are likely to lead to higher prices for end consumers.

TXU believes that “the proposed pro-rating mechanism is less likely to lead to excess revenue recovery than the revised proposal and hence would be more likely to reduce volatility in the transportation charges. In addition, Shippers would be allocated quantities closer to those demanded at the price step at which Transco is prepared to make capacity available. As the pro-rating mechanism is likely to lead to greater quantities of capacity being allocated than the revised mechanism, shippers will be able to achieve greater certainty as to their capacity position, which can only be beneficial”.

BGT argues that “this amendment would transfer risk from Transco to the Shipping Community”. It believes this “proposal will reduce the incentive pressure on Transco and hence increase the likelihood of their maximising their

returns”. Therefore it argued that if this proposal were to be approved, the “incentives package would require a complete review and rewrite”.

SGD argues that if an allocation clears at a higher price step then “the unallocated quantity, for which no demand has been signalled, will be created and offered in subsequent allocations with no guarantee that it will be subsequently purchased. This could have distortionary effects on Transco’s incentives as this excess incremental capacity feeds into its entry capacity and buy back incentives”.

SSE suggests “that from an ‘efficient allocation’ perspective participants in the long-term allocation mechanism have certainty that whatever the cleared price, they will get the volume they requested, which could be argued to be appropriate in the context that the product being purchased is not constrained”.

PPC argues that the “allocation process is still flawed”, as there remains “a lack of reliability of allocation signal for the shipper” and “a risk over reliability of signals for Transco”. PPC argues that “rounding up the allocation and potential investment to the top of the demanded increment and allocating 100% of shippers’ demanded capacity would provide the most accurate signal for Transco and full reliability of allocation for the shippers, so reducing any need to over demand capacity, or be concerned about future price adjustments”.

Transco Response

Transco recognises there has been some concern expressed during the Workstream development of Modification Proposal 0500 about the extent and effects of pro-rating. One aspect of Modification Proposal 0508 was to seek to remove any pro-rating effects. Transco recognises that the auctions and associated processes should support system expansion when Users express a willingness to pay the costs. However the nature of bidding in multiple periods makes that assessment potentially difficult because of the complications associated with determining when and where to release incremental capacity and/or to build in the context of the trade-offs associated with incremental revenues, investment costs and risks of buy backs. Quite simply, individual solutions for each period cannot be derived. Transco considers that the allocation mechanism described in the Supplementary Consultation should be incorporated because it will provide a non-discriminatory clearing mechanism with the whole of the allocation process based on bidders’ valuations rather than pro-rating.

11.24 Supplementary Consultation - Date Of Initial Long Term Auction

Eleven responses were received to the Supplementary Consultation. Of these nine (BGT, ConocoPhillips, CT, Innogy, Entergy-Koch, SGD, SSE, TFE and TFEexp) offered support, TXU offered qualified support and Statoil withheld support in favour of an implementation date no earlier than 1 April 2003.

Statoil agrees that a delay to the proposed allocation date is appropriate but argues that no earlier than 1 April 2003 would be more appropriate. This is based on an assumed lead-time of four or even five months, which it argues would

allow for slippage in resolving the Incremental Entry Capacity Release Statement, Procurement Guidelines and System Management Principles.

TXU is willing to offer qualified support for the proposal but continues to believe that March 2003 would be preferable. Its belief is based on concerns about the proximity of Christmas/New Year holidays and other short-term auctions.

ChevronTexaco and Scottish and Southern welcome the proposal based on an assumption that Ofgem will approve implementation of Modification Proposal 0500 and related documents, including the Incremental Entry Capacity Release Statement, no later than the end of September 2002. Shell gas Direct suggests that it is reasonable to expect all arrangements to be finalised in the next three or four weeks.

BGT, Shell Gas Direct, TXU and ChevronTexaco believe that a three-month period is needed from approval of the Modification Proposal to operation of the bid process.

TFE are willing to accept the proposal as long as the effective date of the provision of the capacity is not delayed beyond 1st October 2004.

BGT believes that it is appropriate to defer until April 2003 the other changes to the capacity regime that have been included as part of Modification Proposal 0500.

Innogy argues that a three-month lead-time should be applied from the finalisation of the long-term capacity arrangements and Shell Gas Direct would prefer that the formulation of paragraph 3 of proposed paragraph 8.1.5 in the Transition Document should read:

Users may make applications for Quarterly System Entry Capacity for each calendar quarter in Gas Year + 3 to Gas Year + 15 (inclusive) pursuant to an annual invitation to be *in a calendar month where the last day of this calendar month is not earlier than three months following the latter of:*

- (i) the acceptance of this modification proposal by the Authority;*
- (ii) the approval by the Authority of the incremental entry capacity release statement and other related supplementary documents;*
- (iii) the publication in Transco's Transportation Statement of the price steps to be used in the allocation following the methodology set out in the IECR;*
- (iv) the acceptance of any related modification proposal, pricing proposal or any other alteration likely to have significant material effect on Users' valuations of entry capacity.*

Shell Gas Direct is not convinced that the legal drafting is now complete and continues to advocate discussion of the legal drafting through a workstream meeting. It also argues that for consistency it would be helpful to have the definitions used in the Network Code cross-reference those used in the proposed GT licence (for example explicitly linking baseline capacity to obligated entry capacity as defined in special condition 28A).

TXU would welcome clarification of whether a revised final modification report will be published.

Transco Response

Transco acknowledges the clear support for implementing this proposal. It recognises the value to all stakeholders of providing a sufficient lead-time to understand the rules for capacity allocation and to formulate appropriate strategies.

Transco does not consider it necessary to further amend the transition arrangements to create an auction date that is conditional upon the date of finalisation of the long-term capacity arrangements and licence documentation. It considers that further material changes to the Network Code are unnecessary and that there is likely to be less confusion arising from a fixed auction date.

Transco considers that early implementation of Modification Proposal 0500 or 0508 would help provide the certainty that a majority of respondents desire regarding the design of long-term entry capacity auctions. It will also enable the Network Code to reflect the use of entry capacity incentive parameters that are expected to be detailed within its GT licence; System Management Principles that will provide new governance for Capacity Management; and introduce a Rolling Monthly System Entry Capacity allocation (RMSEC).

It is proposed that the effective period for capacity offered in the proposed long-term allocation will commence on 1 October 2004.

Transco recognises and supports the desire of a number of respondents for a seminar in which the interactions of the (proposed) GT licence, Supplementary Statements and Network Code might be discussed. Transco would welcome further views on the focus and level of detail that might be expected in such a seminar.

Transco recommends that Modification Proposal 0500 should be implemented as previously submitted to Ofgem, but with the amendments identified in this supplementary consultation.

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 enable Transco to comply with any 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

Transco is unaware of any such requirement.

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

Test revised systems with Transco and Users,
Test linkages between systems,
Implement training programs within Transco and Users,
Amend systems to reflect observations during training and testing,
Re test systems,
Implement changes.

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

Draft Modification Report circulated - 8 February 2002
Consultation period ends - 8 July 2002
Ofgem Decision expected - September 2002

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation.

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:

Clearing price auction of Quarterly System Entry Capacity (QSEC) for years 3 to 15

Pay as bid auction of Monthly System Entry Capacity (MSEC) for years 1 and 2
Rolling Monthly System Entry Capacity (RMSEC) auction for month ahead (pay as bid)

Daily System Entry Capacity (DSEC) available from 13:00 at day ahead to 02:00 within day

Daily Interruptible System Entry Capacity (DISEC) available day ahead only

QSEC auctions to have a 10 day bid window (from 08:00 to 17:00 each day)
Aggregate information published to Users at the end of each day.

Bid window for QSEC could close early, if allocation price stabilises at all ASEPs across all quarters
Auction to be held in August for 2003 onwards.
LTSEC Auction for October 2004 to September 2017 to be held before end of January 2003.
21 price steps available for Users to bid against up to at least 150% of Baseline Capacity
Prices steps to be published in IECR.
Allocation for QSEC based on the rules in the Supplementary Consultation
Allocations to be published to Users within 2 months

MSEC auctions to have a bid window from 08:00 to 17:00 on a single day for capacity from October 2004 onwards
MSEC auction to be held over four rounds for 2002/03 and 2003/04 (due to the greater volume of capacity available)
MSEC Auctions to be held annually in August, but 2002/03 to be offered in two six month auctions (as defined in Modification Proposal 0564) and 2003/04 to be offered for the first time before 31 August 2003
Information provision similar to the existing process
Allocations to be published to Users within 2 months for year 2 and within 1 month for year 1

RMSEC auctions to be held from 08:00 to 17:00 on a single day.
Auction to be held in the last 5 business days of a month
Information provision similar to existing process for MSEC auctions
Allocations to be published to Users within 3 days

No changes to existing processes for DSEC and DISEC

Firm capacity quantities based on proposed Licence requirements
Initially 80% of SO Baseline for years 2 to 15 and 100% of SO Baseline for year 1
Subsequent auctions, capacity offered will be at least the amount Transco retains an obligation to offer for sale
Applies to all firm capacity up to day ahead
Interruptible capacity, an uncapped use-it-or-lose-it quantity released

Overrun charges will be calculated as the greater of:
8 x highest price for firm capacity (QSEC, MSEC, RMSEC, DSEC)
1.1.x volume weighted average price of the top 25% of accepted capacity surrender offers
1.1.x volume weighted average price of the top 25% of accepted capacity forward contracts
1.1.x volume weighted average price of the top 25% of exercised capacity option contracts
All prices to be calculated for each ASEP and each day

No change to the existing neutrality arrangements

Credit arrangements to include

Minimum term of security 12 months

Transco able to recall of capacity if security for the term and value required not received by delivery day

Transco able to recall capacity upon insolvency and termination

Transco able to reject bids if User's exposure is >85% of credit facility

Upon recall and resale, transferee to provide security within 14 days of taking on obligation

Transco has provided legal text to reflect the proposal outlined above.

19. Text

[Draft] proposed legal text

SECTION B: SYSTEM CAPACITY

[Amend paragraph 1.7.3 to read as follows:

"at a System Point, or a charge payable by reference to the arrangements in Special Condition [28B] of the Transco Licence."

Delete all the text at paragraph 2 and insert new text to read as follows:

"2.1 Introduction

2.1.1 Subject to the provisions of the Code, a User may deliver gas to the System at any System Entry Point.

2.1.2 Users may apply for and be registered as holding System Entry Capacity:

- (a) as Quarterly System Entry Capacity pursuant to an auction in accordance with paragraph 2.2;
- (b) as Monthly System Entry Capacity pursuant to an auction in accordance with paragraphs 2.2 and 2.3;
- (c) as Daily System Entry Capacity pursuant to a bid under paragraph 2.4; and
- (d) as Daily Interruptible System Entry Capacity pursuant to a bid under paragraph 2.5.

2.1.3 A User may not apply for or be registered as holding System Entry Capacity at an Aggregate System Entry Point in an amount less than 100,000 kWh/Day (the "**minimum eligible amount**").

2.1.4 In relation to an Aggregate System Entry Point:

- (a) "**Quarterly System Entry Capacity**" is Firm System Entry Capacity which may be applied for and registered as held (in a given amount) by a User for each Day in a particular calendar quarter;
- (b) "**Monthly System Entry Capacity**" is Firm System Entry Capacity which may be applied for and registered as held (in a given amount) by a User for each Day in a particular calendar month;
- (c) "**Daily System Entry Capacity**" is Firm System Entry Capacity which may be applied for and registered as held (in a given amount) by a User for a particular Day only; and
- (d) "**Daily Interruptible System Entry Capacity**" is Interruptible System Entry Capacity which may be applied for and registered as held (in a given amount) by a User for a particular Day only.

2.1.5 In respect of an Aggregate System Entry Point and in relation to a Day in a calendar month in a Formula Year:

- (a) "**Baseline Entry Capacity**" is the amount of System Entry Capacity which Transco is required to make available to Users pursuant to the Transco Licence as set out in the Transportation Statement;
- (b) "**Incremental System Entry Capacity**" is the amount of Firm System Entry Capacity (if any) in excess of the Unsold System Entry Capacity which Transco may (but shall not be required to) invite applications for pursuant to paragraphs 2.2 and 2.3; and
- (c) "**Unsold System Entry Capacity**" is the amount of Firm System Entry Capacity that Transco has, for the purposes of:
 - (i) paragraph 2.2, in relation to each Day in a calendar quarter;
 - (ii) paragraph 2.3, in relation to each Day in a calendar month;
 - (iii) paragraph 2.4, in relation to a Day,

an obligation to make available (in accordance with the procedures set out in this paragraph 2) to Users pursuant to paragraph 14(5)(f) of Part 2 of Special Condition 28B of the Transco Licence as, in the case of System Entry Capacity to be made available under paragraphs 2.2, 2.3 and 2.4 but not paragraph 2.5, set out in the Transportation Statement.

2.1.6 For the purposes of the application of paragraph 2.6, the amount of Unsold System Entry Capacity in existence at a particular time will, unless expressly stated otherwise, be calculated by reference to a continuing obligation to make available Firm System Entry Capacity through the application of paragraph 14(5) of Part 2 of Special Condition 28B of the Transco Licence prior to the time at which the amount of Unsold System Entry Capacity is to be ascertained.

2.1.7 For the purposes of this paragraph 2:

- (a) at any time, in respect of an Aggregate System Entry Point and in relation to a Day, the "**System Entry Capability**" is the amount (in kWh) or rate (in kWh/Day) (in each case consistent with the provisions of paragraph 2.1.9), determined by Transco at such time, as the maximum amount of gas which it will be feasible to take delivery on that Day at that Aggregate System Entry Point, or (as the case may be) the maximum rate at which it will be feasible to take delivery of gas on that Day or in the remaining part of that Day at that Aggregate System Entry Point;
- (b) "**Firm System Entry Capacity**" means Quarterly System Entry Capacity, Monthly System Entry Capacity and Daily System Entry Capacity which (without prejudice to Section I3.7) is not subject to curtailment and "**Interruptible System Entry Capacity**" means Daily Interruptible System Entry Capacity which is liable to be curtailed pursuant to paragraph 2.9;
- (c) a reference to the amount of a User's Available or Registered System Entry Capacity (of any class) at an Aggregate System Entry Point for a Day as "**Adjusted**":
 - (i) pursuant to paragraph 2.8.4, is a reference to such amount as reduced pursuant to that paragraph;

- (ii) pursuant to paragraph 2.9.4, is a reference to such amount as reduced pursuant to that paragraph; and
 - (iii) pursuant to paragraph 2.10.8, is a reference to such amount as determined pursuant to that paragraph,

and a reference to such amount as "**Unadjusted**" pursuant to any such paragraph is a reference to such amount before and disregarding such reduction or determination;
 - (d) a reference to the amount of a User's Available or Registered System Entry Capacity (of any class) at an Aggregate System Entry Point for a Day as "**Fully Adjusted**" is a reference to such amount as adjusted pursuant to paragraphs 2.8.4, 2.9.4 and 2.10.8;
 - (e) an "**invitation date**" is a day on which Users may make applications for System Entry Capacity in accordance with paragraphs 2.2 and 2.3;
 - (f) a "**capacity bid**" is an application for System Entry Capacity in accordance with paragraphs 2.2, 2.3, 2.4 or 2.5; and
 - (g) a "**calendar quarter**" is a period of three calendar months commencing 1 January, 1 April, 1 July and 1 October in any calendar year.
- 2.1.8 All determinations (as to quantities in which or rates at which gas is or is to be delivered to or accepted by the System at an Aggregate System Entry Point) to be made by Transco under this paragraph 2 will be made on the assumption that the requirement in Section I3.10.2 is complied with.
- 2.1.9 For the purposes of determining the System Entry Capacity available to the User for each hour in a Day:
- (a) where the System Entry Capacity is held in respect of the whole Day, the User shall hold in respect of each hour in the Day an amount of the System Entry Capacity equal to the System Entry Capacity held by the User, divided by 24; and
 - (b) where the System Entry Capacity is held for less than a Day, the User shall hold in respect of each remaining hour of the Day an amount of the System Entry Capacity equal to the System Entry Capacity, divided by the period (in hours) from the time the System Entry Capacity was first registered as being held by a User to the end of the Day.
- 2.1.10 References to rates at which gas is or may be delivered to or accepted by the System at an Aggregate System Entry Point are references to an instantaneous rate of flow, whether expressed in kWh/Day or other units.
- 2.1.11 For the avoidance of doubt, where a User ceases to be a User in accordance with Section V4.3, the System Entry Capacity which the User was registered as holding shall (with effect from the latest time by which a transferee election might be made) cease to be treated as held by any User, save to the extent to which any other User elects to be registered as holding such System Entry Capacity pursuant to paragraph 5.4.1(c) (a 'transferee election').

2.1.12 Any price to be specified by Transco or a User pursuant to any provision of this paragraph 2

shall be expressed in pence/kWh/Day and specified to four decimal places.

2.1.13 For the purposes of this paragraph 2 and in particular in the context of applications for System Entry Capacity in accordance with the further provisions of this paragraph 2, a reference to a 'Gas Year + n ' is a reference to the Gas Year commencing on the n anniversary of the first Day of the Gas Year in which the applications are invited to be made.

2.2 Annual System Entry Capacity auctions

2.2.1 By:

- (a) not later than the Day falling twenty eight (28) Days before the first annual invitation date in any Gas Year, Transco will notify Users of the reserve prices and the step prices that will apply in respect of each Aggregate System Entry Point for the purposes of the annual invitation; and
- (b) not earlier than 1 August and not later than 31 August in a Gas Year, Transco will invite, and Users may make, applications for System Entry Capacity in respect of each Aggregate System Entry Point for the periods specified in the invitation in Gas Year + 1 to Gas Year + 15 (inclusive) in accordance with this paragraph 2.2.

2.2.2 Transco will invite applications ("**annual invitation**") for:

- (a) Monthly System Entry Capacity for each calendar month in Gas Year + 1 and Gas Year + 2; and
- (b) Quarterly System Entry Capacity for each calendar quarter in Gas Year + 3 to Gas Year + 15 (inclusive),

in each case for such aggregate amounts of System Entry Capacity as is specified in the annual invitation.

2.2.3 Transco's annual invitation under paragraph 2.2.2 will specify:

- (a) the date(s) (on which applications pursuant to the annual invitation may be made), which for the purposes of:
 - (i) paragraph 2.2.2(a), shall be a Business Day; and
 - (ii) paragraph 2.2.2(b), shall be a period of ten (10) consecutive Business Days ("**annual invitation period**"),(each such date an "**annual**" invitation date);
- (b) for each Aggregate System Entry Point, and in respect of each of Gas Year + 1 to Gas Year + 15 (inclusive), the Available System Entry Capacity and the reserve price for Unsold System Entry Capacity (in accordance with the Transportation Statement) (the "**reserve price**");
- (c) for each Aggregate System Entry Point, and in respect of each of Gas Year + 3 to Gas Year + 15 (inclusive):

- (i) the relevant number of incremental amounts (each being for a different amount) of Quarterly System Entry Capacity greater than the Baseline Entry Capacity (the maximum incremental amount being not less than an amount equal to 150% of Baseline Entry Capacity) (each amount an "**incremental capacity amount**"); and
- (ii) the price payable by Users for each different incremental capacity amount (the "**step price**") were Transco to make such incremental capacity amount available,

in each case (in accordance with the Transportation Statement); and

- (d) the relevant number for the purposes of paragraph (c) being twenty (20) except in the case of an Aggregate System Entry Point where the Baseline Entry Capacity is less than 300,000,000 kWh/Day where the relevant number (being not greater than twenty (20) and not less than five (5)) shall be set out in the Transportation Statement.

2.2.4 Users may apply for Monthly System Entry Capacity for a calendar month in Gas Year + 1 and Gas Year + 2 and/or (without prejudice to paragraph 2.2.14) for Quarterly System Entry Capacity for a calendar quarter in each of Gas Year + 3 to Gas Year + 15 (inclusive) in respect of an Aggregate System Entry Point on the relevant annual invitation dates.

2.2.5 The "**Available System Entry Capacity**" for an Aggregate System Entry Point is, in respect of:

- (a) a calendar month in Gas Year +1 and Gas Year + 2, not less than the sum of:
 - (i) Unsold System Entry Capacity (if any); and
 - (ii) Incremental System Entry Capacity (if any); and
- (b) a calendar quarter in Gas Year + 3 to Gas Year + 15 (inclusive), is not less than the sum of:
 - (i) Unsold System Entry Capacity (if any); and
 - (ii) Incremental System Entry Capacity (if any).

2.2.6 An application (a "**quarterly**" capacity bid) for Quarterly System Entry Capacity in respect of Gas Year + 3 to Gas Year + 15 (inclusive) shall specify:

- (a) the identity of the User;
- (b) the Aggregate System Entry Point;
- (c) the calendar year and calendar quarter for which Quarterly System Entry Capacity is applied for;
- (d) the amount (not less than the minimum eligible amount) of Quarterly System Entry Capacity applied for (in kWh/Day);
- (e) the minimum amount (not less than the minimum eligible amount) of Quarterly System Entry Capacity which the User is willing to be allocated for the purposes of paragraph 2.6.4; and

- (f) the price (being either the reserve price or a step price as set out in the Transportation Statement) in respect of which the User is applying for the amount of Quarterly System Entry Capacity.

2.2.7 An application (a "**monthly**" capacity bid) for Monthly System Entry Capacity in respect of Gas Year + 1 and Gas Year + 2 shall specify:

- (a) the identity of the User;
- (b) the Aggregate System Entry Point;
- (c) the Gas Year and calendar month for which Monthly System Entry Capacity is applied for;
- (d) the amount (not less than the minimum eligible amount) of Monthly System Entry Capacity applied for (in kWh/Day);
- (e) the minimum amount (not less than the minimum eligible amount) of Monthly System Entry Capacity which the User is willing to be allocated for the purposes of paragraph 2.7.2(e); and
- (f) the amount (the "**bid price**") which shall not be less than the reserve price which the User is willing to pay by way of Capacity Charge in respect of the Monthly System Entry Capacity applied for.

2.2.8 A User may have, at any one time:

- (a) on an annual invitation date, up to but not more than twenty (20) monthly capacity bids; and
- (b) during the annual invitation period, up to but not more than twenty one (21) quarterly capacity bids provided that during such period the User may only have one (1) such quarterly capacity bid for which the price specified for the purposes of paragraph 2.2.6(f) is the reserve price or any particular step price,

in respect of a particular Aggregate System Entry Point for each calendar month or (as the case may be) calendar quarter capable of acceptance in accordance with paragraphs 2.6 and 2.7.

2.2.9 A capacity bid:

- (a) may not be submitted before 08:00 hours or after 17:00 hours on an invitation date; and
- (b) may be withdrawn or amended after 08:00 hours and until, but not after, 17:00 hours:
 - (i) where such bid is a monthly capacity bid, on the invitation date;
 - (ii) where such bid is a quarterly capacity bid, on each annual invitation date in the annual invitation period.

2.2.10 Where in relation to the incremental amounts of Quarterly System Entry Capacity specified in an annual invitation the step prices specified:

- (a) increase as the corresponding incremental amount itself increases, Users may only submit a second or further quarterly capacity bid where the step price applied for is greater than that applying to any other bid, if the amount of Quarterly System Entry Capacity applied for in such bid is no greater than that applied for under any earlier bid;
- (b) decrease as the incremental amount itself increases, Users may only submit a second or further Quarterly capacity bid where the step price applied for is less than that applying to any other bid, if the amount of Quarterly System Entry Capacity applied for in such bid is no less than that applied for under any earlier bid.

2.2.11 Transco shall reject a capacity bid submitted on an annual invitation date where:

- (a) the bid price is less than the reserve price or is not a step price;
- (b) the requirement in paragraph 2.2.10 is not complied with;
- (c) any other requirement of paragraphs 2.2.6 or 2.2.7 is not complied with,

and Transco may reject a capacity bid in accordance with Section V3.

2.2.12 Nothing in this paragraph 2.2 shall be construed as giving rise to any restriction on Transco's ability to make available Quarterly System Entry Capacity (or Monthly System Entry Capacity) in an annual invitation in an amount which exceeds the Unsold System Entry Capacity.

2.2.13 In the event that a User submits monthly capacity bids in response to an annual invitation and the sum of:

- (a) the aggregate System Entry Capacity Charges payable by the User where all the Monthly System Entry Capacity applied for under the User's capacity bids in respect of Gas Year +1 to be allocated in full; and
- (b) the User's Relevant Code Indebtedness at 17:00 hours on the Business Day on which monthly capacity bids may be made,

exceeds 85% of the User's Code Credit Limit, Transco shall not later than five (5) Business Days after the last relevant annual invitation date inform the User.

2.2.14 Following a notice under paragraph 2.2.13, in the event the User does not within ten (10) Business Days of such notice provide adequate surety or security (in accordance with the Code Credit Rules), all quarterly capacity bids submitted by the User in response to the annual invitation shall be disregarded for the purposes of this paragraph 2 (and have no effect).

2.2.15 Where at 17:00 hours on the first Business Day of a calendar month in relation to a User the sum of:

- (a) the aggregate System Entry Charges payable by the User in respect of its Registered Quarterly Firm System Entry Capacity for each Day in the twelve (12) calendar months commencing from the first Day of the following calendar month ("**relevant months**"); and
- (b) the User's Relevant Code Indebtedness at such time,

exceeds 85% of its Code Credit Limit Transco shall not later than five (5) Business Days after the first Business Day of the calendar month inform the User.

2.2.16 Following a notice under paragraph 2.2.15, in the event the User does not within ten (10) Business Days of such notice provide adequate surety or security (in accordance with the Code Credit Rules), the User's Registered Quarterly Firm System Entry Capacity for each of the relevant calendar quarters will lapse and the User will cease to be treated as holding the Registered Quarterly Firm System Entry Capacity.

2.2.17 Following the submission of quarterly capacity bids on each annual invitation date in the annual invitation period Transco will as soon as reasonably practicable after 17:00 hours on each such date identify, and notify Users of, the prevailing relevant step price group (by reference to the quantities of Quarterly System Entry Capacity applied for in aggregate by Users up until such time and on the basis of a provisional allocation of capacity in accordance with paragraph 2.6 exclusive of capacity to be made pursuant to the Incremental Entry Capacity Release Statement) and in the event the relevant step price group remains identical to the prevailing relevant step price group identified in respect of bids submitted by Users by 17:00 hours on the immediately preceding annual invitation date:

- (a) Transco shall by not later than 08:00 hours on the following annual invitation date, notify Users that this paragraph 2.2.17 applies and that the annual invitation period has ended; and
- (b) Users shall not be permitted to submit and Transco shall not be permitted to accept any further quarterly capacity bids in respect of the annual invitation.

2.3 Rolling Monthly System Entry Capacity auctions

2.3.1 In respect of an Aggregate System Entry Point where there is in relation to a calendar month Unsold System Entry Capacity Transco will invite applications (a "**rolling monthly invitation**") for Monthly System Entry Capacity (in an amount not less than the sum of Unsold System Entry Capacity (if any) and Incremental System Entry Capacity (if any)) in respect of the Aggregate System Entry Point for the relevant calendar month in accordance with this paragraph 2.3.

2.3.2 Transco's rolling monthly invitation under paragraph 2.3.1 will specify:

- (a) the date (a "**rolling monthly**" invitation date) being one of the five (5) Business Days preceding the last Business Day in the calendar month preceding the relevant calendar month for which applications may be made) on which applications pursuant to the rolling monthly invitation may be made; and
- (b) for each Aggregate System Entry Point, the amount of Monthly System Entry Capacity to be made available; and
- (c) the reserve price to be applied.

2.3.3 Users may apply for Monthly System Entry Capacity in respect of an Aggregate System Entry Point in the relevant calendar month on a rolling monthly invitation date.

2.3.4 An application (a "**rolling monthly**" capacity bid) for Monthly System Entry Capacity shall specify:

- (a) the identity of the User;

- (b) the Aggregate System Entry Point;
- (c) the calendar month for which Monthly System Entry Capacity is applied for;
- (d) the amount (not less than the minimum eligible amount) of Monthly System Entry Capacity applied for (in kWh/Day);
- (e) the minimum amount (not less than the minimum eligible amount) of Monthly System Entry Capacity which the User is willing to be allocated for the purposes of paragraph 2.7.2(e); and
- (f) the amount (the "**bid price**"), which shall not be less than the reserve price which the User is willing to pay by way of Capacity Charge in respect of the Monthly System Entry Capacity applied for.

2.3.5 A rolling monthly capacity bid:

- (a) may not be submitted before 08:00 hours or after 17:00 hours on a rolling monthly invitation date; and
- (b) may be withdrawn or amended until, but not after, 17:00 hours on a rolling monthly invitation date.

2.3.6 Transco shall reject a rolling monthly capacity bid where:

- (a) the bid price is less than the reserve price;
 - (b) any other requirement of paragraph 2.3.4 is not complied with,
- and Transco may reject a rolling monthly capacity bid in accordance with Section V3.

2.4 **Daily System Entry Capacity**

2.4.1 Users may apply for Daily System Entry Capacity in respect of an Aggregate System Entry Point for a Day in accordance with this paragraph 2.4.

2.4.2 An application (a "**daily**" capacity bid) for Daily System Entry Capacity shall specify:

- (a) the identity of the User;
- (b) the Aggregate System Entry Point;
- (c) the Day for which the Daily System Entry Capacity is applied for;
- (d) the amount (not less than the minimum eligible amount) of Daily System Entry Capacity applied for;
- (e) the minimum amount (not less than the minimum eligible amount) of Daily System Entry Capacity which the User is willing to be allocated for the purposes of paragraph 2.7.2(e);
- (f) the amount (the "**bid price**"), which shall not be less than the reserve price which the User is willing to pay by way of Capacity Charge in respect of the Daily System Entry Capacity applied for; and
- (g) whether such bid is a fixed or reducing daily capacity bid.

2.4.3 A daily capacity bid:

- (a) may be submitted at any time from the 7th Day before the Gas Flow Day until 02:00 hours on the Day for which the Daily System Entry Capacity is applied for; and
- (b) may, subject to paragraph 2.4.4, in the case of a fixed bid be withdrawn or amended and in the case of a reducing bid withdrawn, at any time before Daily System Entry Capacity is allocated in respect of such bid.

2.4.4 A daily capacity bid may not be withdrawn during a capacity allocation period (irrespective of whether or not the daily capacity bid is in relation to an Aggregate System Entry Point at which, for the purposes of the capacity allocation, there is Available Daily Capacity) and where a User seeks to withdraw a bid during such period, Transco will notify the User that a capacity allocation period is current and Transco may, subject to paragraph 2.4.6, accept such daily capacity bid.

2.4.5 In relation to each Aggregate System Entry Point and in respect of any Day (or part of any such Day) a User may have, at any one time, up to but not more than twenty (20) daily capacity bids which are capable of acceptance in accordance with this paragraph 2.4.

2.4.6 Transco shall reject a daily capacity bid where:

- (a) the bid price is less than the reserve price;
- (b) any other requirement of paragraph 2.4.2 is not complied with,

and Transco may reject a daily capacity bid in accordance with Section V3.

2.4.7 For each Day (or part of each such Day) in respect of each Aggregate System Entry Point, where Available Day-ahead Capacity is available or where Transco determines that Available Within-Day Capacity is available at one or more Aggregate System Entry Points, Transco will initiate a capacity allocation period and for the purposes of paragraph 2.7.2(b)(iii):

- (a) where the capacity allocation period commences before 06:00 hours on the Day in respect of which Daily System Entry Capacity will be allocated, the Available Daily Capacity shall be the Available Day-ahead Capacity; and
- (b) where the capacity allocation period commences on or after 06:00 hours on the Day in respect of which Daily System Entry Capacity will be allocated, the Available Daily Capacity shall be the Available Within-Day Capacity.

2.4.8 Where Transco has initiated a capacity allocation period or for the purposes of paragraph 2.4.11, Daily System Entry Capacity (up to the amount, if any, of the Available Daily Capacity) will be allocated in accordance with paragraph 2.7.

2.4.9 Subject to paragraph 2.7.3, Transco will accept bids in respect of which Daily System Entry Capacity is allocated in accordance with paragraph 2.7.2, and each User whose bid is so accepted will be registered as holding Daily System Entry Capacity (in the amount so allocated) for the Day in respect of the Aggregate System Entry Point.

- 2.4.10 Where there is no Available Daily Capacity in respect of an Aggregate System Entry Point for a Day, or the amount thereof is less than the minimum eligible amount, Transco will not accept any daily capacity bids.
- 2.4.11 Daily capacity bids will also be selected for acceptance in accordance with the System Management Principles.
- 2.4.12 Transco will accept daily capacity bids selected pursuant to paragraph 2.7.2 or 2.4.11 and the amount of Available Daily Capacity for the Day at the Aggregate System Entry Point will be decreased by the amount for which the bid was selected.
- 2.4.13 For the purposes of this paragraph 2.4:
- (a) the "**ASEP Non-specific Available Within-Day Capacity**" in respect of two or more Aggregate System Entry Points (each a "**relevant**" Aggregate System Entry Point), for any Day or part of such Day, is the amount determined by Transco, by which System Entry Capacity exceeds the Firm System Entry Capacity at each relevant Aggregate System Entry Point for the time being held by Users in aggregate (including pursuant to any preceding capacity allocation);
 - (c) the "**ASEP Specific Available Within-Day Capacity**" in respect of an Aggregate System Entry Point, for any Day or part of such Day, is the amount determined by Transco, by which System Entry Capacity exceeds the Firm System Entry Capacity for the time being held by Users in aggregate (including pursuant to any preceding capacity allocation);
 - (d) the "**Available Daily Capacity**" in relation to an Aggregate System Entry Point for any Day or remaining part of any such Day, is as appropriate, the Available Day-ahead Capacity or the Available Within-day Capacity
 - (e) the "**Available Day-ahead Capacity**" in relation to an Aggregate System Entry Point, is an amount of Daily System Entry Capacity equivalent to the sum of Unsold System Entry Capacity (which was available for such Day in accordance with paragraph 2.3 (if any)) which remains available following the application of paragraph 2.3 in respect of each Day in the calendar month in which such Day falls and any additional Daily System Entry Capacity that Transco may in its sole discretion choose to make available for the Day (if any);
 - (f) the "**Available Within-Day Capacity**" in relation to an Aggregate System Entry Point, for a Day or any remaining part of such Day is the greater of the:
 - (i) ASEP Specific Available Within-Day Capacity (if any);
 - (ii) ASEP Non-specific Available Within-Day Capacity (if any);
and
 - (iii) the Unsold System Entry Capacity (if any);
 - (g) the "**bid effective time**" is the time on the hour in relation to a daily capacity bid being the later of:
 - (i) 06:00 hours on the Gas Flow Day; or

- (ii) the time falling no earlier than 60 minutes after Daily System Entry Capacity has been allocated in respect of such bid;
- (h) a "**capacity allocation period**" is the period of 15 minutes, in which Transco conducts capacity allocation at an Aggregate System Entry Point for a Day, and which subject to there being Available Daily Capacity and available daily capacity bids at such time:
 - (i) first commences at 13:00 hours on the Preceding Day to that for which the Daily System Entry Capacity is applied for;
 - (ii) commences on any hour bar falling thereafter up to and including 02:00 hours on the Day for which the Daily System Entry Capacity is applied for (but not thereafter);
- (i) a "**capacity allocation**" is the allocation of Daily System Entry Capacity during a capacity allocation period in accordance with paragraph 2.7;
- (j) a "**fixed bid**", is a daily capacity bid in relation to which the Daily System Entry Capacity applied for is not conditional on the bid effective time and a "**reducing bid**" is a daily capacity bid in relation to which the amount of Daily Entry Capacity applied for is determined as:

$$(DSEC / BET) * N$$

where:

DSEC is the amount of Daily System Entry Capacity applied for when the bid was first submitted;

BET commencing from the earliest bid effective time in respect of such bid, the number of hours remaining on the Gas Flow Day;

N the number of hours remaining from the actual bid effective time were Daily System Entry Capacity to be allocated in respect of such a bid.

2.4.14 A daily capacity bid is "**available**" where:

- (a) submitted and not withdrawn prior to the start of any capacity allocation period; and
- (b) the bid effective time is later than 06:00 on the Gas Flow Day, the implied capacity rate is less than or equal to the available capacity rate at the relevant Aggregate System Entry Point,

and for the avoidance of doubt, where Daily System Entry Capacity is allocated in respect of a bid such bid shall be extinguished and no longer be available for the purposes of paragraph 2.7.

2.4.15 For the purposes of this paragraph 2.4:

- (a) the "**available capacity rate**" in relation to an Aggregate System Entry Point is the rate (in kWh/hour) calculated as an amount of Daily System Entry Capacity equal, as appropriate, to the Available Daily Capacity, divided by the

number of hours remaining in the Day following the capacity allocation effective time;

- (b) the "**capacity allocation effective time**" is:
 - (i) where the capacity allocation period ends prior to 04:00 hours on the Preceding Day, 06:00 on the Gas Flow Day;
 - (ii) the hour bar following the next hour bar falling after the end of a capacity allocation period;
- (c) the "**implied capacity rate**" in relation to a:
 - (i) fixed bid, is the rate (in kWh/hour), calculated as the amount of Daily System Entry Capacity in respect of which the bid was made divided by the number of hours remaining in the Day were Daily System Entry Capacity to be allocated in respect of such bid;
 - (ii) reducing bid, is the rate (in kWh/hour) calculated as the amount of Daily System Entry Capacity in respect of which the bid was made divided by the number of hours remaining in the Day from the hour bar following the hour bar next falling after submission of such bid.

2.5 Daily Interruptible System Entry Capacity

2.5.1 Users may apply for Daily Interruptible System Entry Capacity in respect of an Aggregate System Entry Point for a Day in accordance with this paragraph 2.5.

2.5.2 An application (a "**daily interruptible**" capacity bid) for Daily Interruptible System Entry Capacity pursuant to this paragraph 2.5 shall specify:

- (a) the identity of the User;
- (b) the Aggregate System Entry Point;
- (c) the Day for which the Daily Interruptible System Entry Capacity is applied for;
- (d) the amount (not less than the minimum eligible amount) of Daily Interruptible System Entry Capacity applied for;
- (e) the minimum amount (not less than the minimum eligible amount) of Daily Interruptible System Entry Capacity which the User is willing to be allocated for the purposes of paragraph 2.7.2(e); and
- (f) the amount (the "**bid price**"), which shall not be less than the reserve price which the User is willing to pay by way of Capacity Charge in respect of the Daily Interruptible System Entry Capacity applied for.

2.5.3 A daily interruptible capacity bid:

- (a) may be submitted at any time from the 7th Day before the Gas Flow Day until 13:00 hours on the Preceding Day; and
- (b) may be withdrawn or amended until, but not after, 13:00 hours on the Preceding Day.

- 2.5.4 For each Day, in respect of each Aggregate System Entry Point:
- (a) Transco will notify Users of the amount of Available Interruptible Capacity by not later than 12:00 hours on the Preceding Day; and
 - (b) Daily Interruptible System Entry Capacity (up to the amount if any of the Available Interruptible Capacity) will be allocated pursuant to daily interruptible capacity bids in accordance with paragraph 2.7.
- 2.5.5 In relation to each Aggregate System Entry Point and in respect of any Day a User may have, at any one time, up to but not more than 20 daily interruptible capacity bids which are capable of acceptance in accordance with paragraph 2.7.
- 2.5.6 Transco will reject a daily interruptible capacity bid where:
- (a) the bid price is less than the reserve price;
 - (b) any other requirement of paragraph 2.5.2 is not complied with,
- and Transco may reject a daily interruptible capacity bid in accordance with Section V3.
- 2.5.7 Subject to paragraph 2.7.3, Transco will accept bids in respect of which Daily Interruptible System Entry Capacity is allocated in accordance with paragraph 2.7.2, and each User whose bid is so accepted will be registered as holding Daily Interruptible System Entry Capacity (in the amount so allocated) for the Day in respect of the Aggregate System Entry Point.
- 2.5.8 Where there is no Available Interruptible Capacity in respect of an Aggregate System Entry Point for a Day, or the amount thereof is less than the minimum eligible amount, Transco will not accept any daily interruptible capacity bids.
- 2.5.9 Transco will, not later than 15:00 hours on the Preceding Day, inform each User of those of its daily interruptible capacity bids which have been accepted and the amount of Daily Interruptible System Entry Capacity which it is registered as holding pursuant to each such accepted bid.
- 2.5.10 For the purposes of this paragraph 2.5 the "**Available Interruptible Capacity**" in respect of an Aggregate System Entry Point for any Day is an amount of System Entry Capacity equal to the daily average unutilised firm capacity.
- 2.5.11 The "**daily average unutilised firm capacity**" in respect of any relevant period in relation to an Aggregate System Entry Point is an amount of System Entry Capacity equal to:

$$\text{AUC} / 30$$

where:

AUC is the aggregate amount, for each relevant day, by which the Firm System Entry Capacity at the Aggregate System Entry Point held by Users in aggregate exceeds the sum of the Entry Point Daily Quantity Delivered for each System Entry Point comprised in the Aggregate System Entry Point,

and a "**relevant day**" is each of the thirty (30) Days up to (and including) the Day falling seven (7) Days before the first Day in any relevant period and "**relevant period**" is a period of seven (7) consecutive Days .

2.6 Allocation: Quarterly System Entry Capacity

2.6.1 Following an annual invitation and in relation to an Aggregate System Entry Point and a calendar quarter where the Reserve Price Bid Amount:

- will
- (a) is equal to or less than the Unsold System Entry Capacity, paragraph 2.6.2 will apply;
 - (b) is greater than the Unsold System Entry Capacity, paragraph 2.6.3 will apply (other than where the circumstances in paragraph 2.6.4 exist in which case such paragraph shall apply) .

2.6.2 Where this paragraph 2.6.2 applies pursuant to paragraph 2.6.1:

- (a) Quarterly System Entry Capacity will be allocated to each quarterly capacity bid (excluding any quarterly capacity bid rejected pursuant to paragraph 2.2.11) in the amount of Quarterly System Entry Capacity applied for; and
- (b) the User agrees to pay by way of System Entry Charge for the Quarterly System Entry Capacity allocated in accordance with paragraph (a) the applicable reserve price for the calendar quarter.

2.6.3 Where this paragraph 2.6.3 applies pursuant to paragraph 2.6.1, subject to paragraph 2.6.4:

- (a) Quarterly System Entry Capacity will be allocated to each quarterly capacity bid in the relevant step price group (excluding any quarterly capacity bid rejected pursuant to paragraph 2.2.11) in the amount of Quarterly System Entry Capacity applied for; and
- (b) the User agrees to pay by way of System Entry Charge for the Quarterly System Entry Capacity allocated in accordance with paragraph (a) the step price corresponding to the relevant step price group for the calendar quarter.

2.6.4 In the event that there is no relevant step price group the Actual Available System Entry Capacity will be allocated to each quarterly capacity bid:

- (a) where paragraph 2.2.10(a) applies, in the step price group for which Users specified the highest step price when applying for Quarterly System Entry Capacity;
- (b) where paragraph 2.2.10(b) applies, in the step price group for which the incremental capacity amount which is equal to the Actual Aggregate System Entry Capacity,

(in each case excluding any quarterly capacity bid rejected pursuant to paragraph 2.2.11) pro rata the amount applied for (provided that where the amount to be allocated is less than the minimum amount specified in the quarterly capacity bid, the bid will be disregarded (and have no effect) and a revised allocation will be made between the quarterly capacity bids in accordance with this paragraph).

2.6.5 For the purposes of this paragraph 2.6, and in respect of an Aggregate System Entry in relation to a calendar quarter:

- (a) **"Actual Available System Entry Capacity"** is, following an annual invitation, an amount of Quarterly System Entry Capacity equal to the sum of:
 - (i) Unsold System Entry Capacity (as determined prior to the annual invitation);
 - (ii) any additional Quarterly System Entry Capacity which Transco is required to make available pursuant to the Incremental Entry Capacity Release Statement following the submission of quarterly capacity bids in response to the annual invitation; and
 - (iii) any additional Quarterly System Entry Capacity which Transco in its sole discretion determines to make available to Users;
- (b) the **"relevant step price group"** is the step price group, when considering the incremental quantities specified in the annual invitation in ascending order, in respect of which the step price group quantity is first equal to or less than the Actual Available System Entry Capacity;
- (c) the **"Reserve Price Bid Amount"** is, in relation to an annual invitation, the aggregate amount of Quarterly System Entry Capacity applied for pursuant to quarterly capacity bids in respect of which different Users specified a price other than a step price when applying for Quarterly System Entry Capacity;
- (d) a **"step price group"** are those quarterly capacity bids in respect of which different Users specified the same step price when applying for Quarterly System Entry Capacity; and
- (e) the **"step price group quantity"** is the aggregate amount of Quarterly System Entry Capacity applied for by Users pursuant to quarterly capacity bids comprised in a step price group.

2.6.6 Transco will accept quarterly capacity bids in respect of which Quarterly System Entry Capacity is allocated in accordance with paragraphs 2.6.2, 2.6.3 and 2.6.4, and each User whose bid is so accepted will be registered as holding Quarterly System Entry Capacity (in the amount so allocated) for the relevant calendar quarter in respect of the Aggregate System Entry Point.

2.6.7 Transco will, not later than:

- (a) two months following the last annual invitation date in a Gas Year inform each User of those of its quarterly capacity bids which have been accepted and the amount of Quarterly System Entry Capacity which it is registered as holding for each calendar quarter pursuant to each such accepted quarterly capacity bid; and
- (b) twenty four (24) hours after the time at which Transco notifies Users in accordance with paragraph (a) notify all Users in respect of each calendar quarter in accordance with paragraph 2.14.2.

2.7 Allocation: Monthly, Daily and Daily Interruptible System Entry Capacity

- 2.7.1 Following the submission of monthly capacity bids, rolling monthly, daily capacity bids and daily interruptible capacity bids, System Entry Capacity will be allocated for a relevant short term period in accordance with this paragraph 2.7.
- 2.7.2 For a relevant short term period, System Entry Capacity in respect of an Aggregate System Entry Point will be allocated pursuant to capacity bids submitted in respect of such short term period as follows:
- (a) all capacity bids submitted in respect of the relevant short term period (excluding any bid rejected pursuant to paragraphs 2.2.11, 2.3.6, 2.4.6 or 2.5.6) will be ranked in order of bid price (the highest priced ranking first);
 - (b) System Entry Capacity will be allocated in respect of each bid, in descending order of bid price starting with the highest priced, in the amount applied for, until the amount of System Entry Capacity in aggregate for which bids are accepted is equal to (or falls short by no more than the minimum eligible amount of):
 - (i) in the case of monthly capacity bids made pursuant to paragraphs 2.2.4, the Available System Entry Capacity for the calendar month;
 - (ii) in the case of rolling monthly capacity bids made pursuant to paragraphs 2.3.3, the amount of Monthly System Entry Capacity for the calendar month;
 - (iii) in the case of daily capacity bids made pursuant to paragraph 2.4.1 the Available Daily Capacity; and
 - (iv) in the case of daily interruptible capacity bids made pursuant to paragraph 2.5.1, the Available Interruptible Capacity;
 - (c) subject to paragraphs (d) and (e) and paragraph 2.7.3, where the amount of System Entry Capacity applied for under a bid exceeds the amount (the "**remaining unallocated amount**") of the relevant capacity remaining unallocated after allocation to higher priced bids, the User will be allocated an amount equal to the remaining unallocated amount;
 - (d) subject to paragraph (e) and paragraph 2.7.3, where each of two or more bids ("**equal priced bids**") specifies the same bid price, and the amount of relevant capacity remaining applied for in aggregate under such bids exceeds the remaining unallocated amount, the remaining unallocated amount will be allocated pro rata the amounts applied for in each such bid;
 - (e) where the amount to be allocated in respect of a bid pursuant to paragraph (c) or (d) is less than the minimum amount specified in the capacity bid, the bid will be disregarded (and of no effect), and a revised allocation will be made between remaining equal price bid(s) under paragraph (d), or (as the case may be) an allocation made in respect of the next priced bid.
- 2.7.3 Where the amount to be allocated in respect of any bid pursuant to paragraph 2.7.2 is less than the minimum eligible amount, Transco will not accept that or any further capacity bids under, as appropriate, paragraphs 2.2, 2.3, 2.4 or 2.5.
- 2.7.4 Subject to paragraph 2.7.2, Transco will accept bids in respect of which System Entry Capacity is allocated in accordance with paragraph 2.7.2, and each User whose bid is

so accepted will be registered as holding System Entry Capacity (in the amount so allocated) for the relevant short term period in respect of the Aggregate System Entry Point.

2.7.5 Each User who applies for System Entry Capacity for a relevant short term period shall tender in respect of each capacity bid a bid price (in accordance with paragraphs 2.2.7(f), 2.3.4(f), 2.4.2(f) or 2.5.2(f)) and agrees by making such application to pay by way of System Entry Capacity Charges the relevant bid price for the relevant short term period in respect of the System Entry Capacity allocated in accordance with this paragraph 2.7 pursuant to such capacity bid.

2.7.6 For the purposes of this paragraph 2.7:

- (a) **"relevant short term period"** means:
 - (i) in the case of an annual invitation or a rolling monthly invitation under paragraphs 2.2 and 2.3, the relevant calendar month; and
 - (ii) for the purposes of paragraphs 2.4 and 2.5, the relevant Day; and
- (b) **"relevant capacity remaining"** is, for the purposes of an allocation in accordance with paragraph 2.7.2 following applications made under:
 - (i) paragraphs 2.2.5 or 2.3.3, Monthly System Entry Capacity;
 - (ii) paragraph 2.4.1, Daily System Entry Capacity; and
 - (iii) paragraph 2.5.1, Daily Interruptible System Entry Capacity.

2.7.7 Transco will:

- (a) in respect of Monthly System Entry Capacity allocated in respect of Gas Year + 1 not later than one month following the date on which applications for Monthly System Entry Capacity could be made, inform each User of those of its monthly capacity bids which have been accepted and the amount of Monthly System Entry Capacity which it is registered as holding for each calendar month in Gas Year +1 pursuant to each such accepted monthly capacity bid;
- (b) in respect of Monthly System Entry Capacity allocated in respect of Gas Year + 2 not later than two months following the date on which applications for Monthly System Entry Capacity could be made, inform each User of those of its monthly capacity bids which have been accepted and the amount of Monthly System Entry Capacity which it is registered as holding for each calendar month in Gas Year + 2;
- (c) in respect of Monthly System Entry Capacity allocated in respect of a calendar month not later than three (3) Business Days following rolling monthly invitation inform each User of those of its rolling monthly capacity bids which have been accepted and the amount of Monthly System Entry Capacity which it is registered as holding for the calendar month;
- (d) one (1) hour after a capacity allocation of Daily System Entry Capacity and Daily Interruptible System Entry Capacity inform each User of those of its capacity bids which have been accepted and the amount of Daily System

Entry Capacity and Daily Interruptible System Entry Capacity which it is registered as holding pursuant to each such accepted capacity bid; and

- (e) twenty four (24) hours after the time at which Transco notifies Users in accordance with paragraph (a), (b), (c) and (d) notify all Users [in respect of each relevant short term period in accordance with paragraph 2.14.2.

2.8 Capacity Constraint Management

2.8.1 Transco may, for the purposes of Capacity Management:

- (a) initiate a capacity allocation period in accordance with the System Management Principles; and
- (b) undertake Capacity Management in accordance with the System Management Principles (which may include the acceptance of daily capacity offers on any Day at an Aggregate System Entry Point in such aggregate amounts as is consistent with the System Management Principles).

2.8.2 For the purposes of the Code:

- (a) "**Capacity Management**" means, in relation to an Aggregate System Entry Point and in relation to any Day:
 - (i) the entering into of a Capacity Management Agreement by Transco; and/or
 - (ii) the curtailment of Interruptible System Entry Capacity in accordance with paragraphs 2.9; and/or
 - (iii) the acceptance by Transco of daily capacity offers submitted by Users in accordance with paragraph 2.10,

in each case in accordance with the System Management Principles (and this paragraph 2);

- (b) "**Capacity Management Charges**" are all amounts payable by Transco to a User pursuant to a Capacity Management Agreement and include Capacity Surrender Charges; and
- (c) a "**Capacity Management Agreement**" is any form of agreement (or mechanism) identified in the statement to be prepared and published by Transco pursuant to Special Condition 27(3) of the Transco Licence which may be utilised by Transco and pursuant to which Transco may secure the surrender of Firm System Entry Capacity by Users for the purposes of the management of a capacity constraint.

2.8.3 Transco may enter into a Capacity Management Agreement with a User.

2.8.4 Where pursuant to the terms of a Capacity Management Agreement a User surrenders Firm System Entry Capacity at an Aggregate System Entry Point in relation to a Day, the amount of the User's Available Firm System Entry Capacity at the Aggregate System Entry Point shall be reduced by the amount surrendered by the User pursuant to the terms of the Capacity Management Agreement.

- 2.8.5 Capacity Surrender Charges will be invoiced and payable in accordance with Section S.
- 2.8.6 Transco shall for the purposes of the management of a capacity constraint take such steps as are in accordance with the System Management Principles; it however being acknowledged that the System Management Principles do not form part of, and are not incorporated into, and are not binding upon Transco pursuant to, the Code.
- 2.8.7 For the avoidance of doubt, Transco shall not be under any obligation pursuant to paragraphs 2.2, 2.3, 2.4, 2.5 or any other provision of this Section B2 to make available to Users System Entry Capacity surrendered by Users pursuant to the terms of a Capacity Management Agreement.

2.9 Curtailment of Interruptible System Entry Capacity

- 2.9.1 For the purposes of this paragraph 2.9, an "**Entry Capability Shortfall**" in respect of an Aggregate System Entry Point for a Day is the amount (in kWh) by which the amount of (or rate at which) gas is or will be delivered exceeds the System Entry Capability (as determined by Transco).
- 2.9.2 Where at any time after 15:00 hours on the Preceding Day Transco determines in relation to any Aggregate System Entry Point that there is or will be an Entry Capability Shortfall, the Interruptible System Entry Capacity held by Users at that Aggregate System Entry Point will be curtailed subject to and in accordance with the System Management Principles and the further provisions of this paragraph 2.9.
- 2.9.3 Transco will give a notice ("**interruptible curtailment notice**") to all Users specifying:
- (a) the Aggregate System Entry Point and the Day to which the notice relates;
 - (b) the time ("**curtailment effective time**") with effect from which such curtailment is to take place, which shall be on the hour, shall not be earlier than 06:00 hours nor later than 02:00 hours on the Gas Flow Day, and shall not be less than 60 minutes after such notice is given; and
 - (c) a factor ("**interruptible curtailment factor**") determined in accordance with the System Management Principles.
- 2.9.4 Where Transco gives an interruptible curtailment notice, the amount of each User's Available Interruptible System Entry Capacity (excluding any negative Available Interruptible System Entry Capacity) will be determined as:

$$R * (ICF1 * P1 + ICF2 * P2 + + ICFn * Pn) / 24$$

where R is the amount of the User's Available Interruptible System Entry Capacity for the Day;

and where for each interruptible curtailment notice (from 1 to n) given in respect of the Aggregate System Entry Point and the Day:

ICF is the interruptible curtailment factor, and

P is the period in hours from the curtailment effective time until the end of the Gas Flow Day or (if earlier) the curtailment effective time of a subsequent curtailment notice,

and for the purposes of which, in the absence of any other interruptible curtailment notice, there shall be deemed to be an interruptible curtailment notice specifying an interruptible curtailment factor of one (1) in force at the start of the Gas Flow Day.

2.10 Surrender of System Entry Capacity

2.10.1 Users may offer to surrender Available Firm System Entry Capacity for a Day in respect of an Aggregate System Entry Point, and Transco may accept such offers, subject to and in accordance with the System Management Principles and this paragraph 2.10.

2.10.2 An offer ("**daily capacity offer**") to surrender Firm System Entry Capacity pursuant to this paragraph 2.10 shall specify:

- (a) the identity of the User;
- (b) the Aggregate System Entry Point;
- (c) the Day for which System Entry Capacity is offered for surrender;
- (d) the amount (not less than the minimum eligible amount) of System Entry Capacity offered for surrender (in kWh/Day);
- (e) the minimum amount (not less than the minimum eligible amount) of System Entry Capacity for which the User is willing to have the offer accepted;
- (f) the amount (the "**offer price**") in pence/kWh/Day which the User wishes to be paid in respect of the of the surrender of the offered System Entry Capacity; and
- (g) whether such offer is a fixed or reducing daily capacity offer.

2.10.3 A daily capacity offer:

- (a) may be submitted at any time from 06:00 hours on the 7th Day before the Gas Flow Day until 02:00 hours on the Day for which the System Entry Capacity is offered for surrender; and
- (b) may, subject to paragraph 2.10.4, in the case of a fixed offer be withdrawn or amended and in the case of a reducing offer be withdrawn, at any time before System Entry Capacity in such bid is selected for surrender.

2.10.4 A daily capacity offer may not be withdrawn during a capacity selection period (irrespective of whether or not the daily capacity offer is in relation to an Aggregate System Entry Point at which, for the purposes of capacity selection, there is a Firm Capacity Shortfall) and where a User seeks to withdraw an offer during such period, Transco will notify the User that a capacity selection period is current and Transco may, subject to paragraph 2.10.6, accept such daily capacity offer.

2.10.5 In relation to each Aggregate System Entry Point and in respect of any Day (or part of any such Day) a User may have, at any one time, up to but not more than twenty (20)

daily capacity offers which are capable of acceptance in accordance with this paragraph 2.10.

- 2.10.6 Transco will reject a daily capacity offer where any requirement of paragraph 2.10.2 is not complied with, and may reject such an offer where the amount of System Entry Capacity offered for surrender exceeds the amount of the User's Available Firm System Entry Capacity (determined by reference to System Capacity Transfers which have at the relevant time become effective pursuant to paragraph 5.2.4 and the provisions of paragraph 2.8 and this paragraph 2.10).
- 2.10.7 For each Day (or part of each such Day) in respect of each Aggregate System Entry Point, where Transco determines that there is a Firm Capacity Shortfall at one or more Aggregate System Entry Points, Transco will initiate, not earlier than 13:00 hours on the Preceding Day, a capacity selection period.
- 2.10.8 Transco may accept daily capacity offers in accordance with the System Management Principles and the amount of Available Firm System Entry Capacity held (for the relevant Day in respect of the relevant Aggregate System Entry Point) by each User whose offer is so accepted will be reduced by the amount for which the offer was selected.
- 2.10.9 Transco will, not later than one (1) hour after each capacity selection, inform each User of those of its daily capacity offers which have been accepted, the amount of System Entry Capacity surrendered pursuant to each such accepted offer, and the amount by which its Available System Entry Capacity is accordingly reduced in respect of each Aggregate System Entry Point.
- 2.10.10 For the purposes of this paragraph 2.10:
 - (a) the "**offer effective time**" is the time on the hour in relation to a daily capacity offer being the later of:
 - (i) 06:00 hours on the Gas Flow Day; and
 - (ii) the time not earlier than 60 minutes after Firm System Entry Capacity has been selected pursuant to such bid for surrender;
 - (b) a "**capacity selection period**" is the period of 15 minutes in which, where Transco intends to accept Firm System Entry Capacity for surrender pursuant to available daily capacity offers, it conducts a capacity selection;
 - (c) a "**capacity selection**" is the acceptance of Firm System Entry Capacity for surrender during a capacity selection period in accordance with this paragraph 2.10;
 - (d) a "**fixed offer**", is a daily capacity offer in relation to which the amount of Firm System Entry Capacity offered for surrender is not conditional on the offer effective time and a "**reducing offer**" is a daily capacity offer in relation to which the amount of Firm Entry Capacity offered for surrender is determined as:

$$(FSEC / OET) * N$$

where:

- FSEC is the amount of Firm System Entry Capacity offered for surrender when the offer was first submitted;
 - OET commencing from the earliest offer effective time in respect of such bid, the number of hours remaining on the Gas Flow Day; and
 - N the number of hours remaining from the actual offer effective time were Firm System Entry Capacity to be selected for surrender pursuant to such offer; and
- (e) a "**Firm Capacity Shortfall**" is an amount of Firm System Entry Capacity equal to the amount by which the lesser of Transco's estimate of the amount of gas that will be delivered to the System at the Aggregate System Entry Point during a Day (or part thereof) and the Aggregate Registered Firm System Entry Capacity held by all Users at that Aggregate System Entry Point exceeds the System Entry Capability at that Aggregate System Entry Point.

2.10.11 A daily capacity offer is "**available**" where:

- (a) submitted and not withdrawn prior to the start of any capacity selection period; and
- (b) where the offer effective time is later than 06:00 on the Gas Flow Day, the implied surrender rate is less than or equal to the available surrender rate at the relevant Aggregate System Entry Point,

and for the avoidance of doubt, where Firm System Entry Capacity is selected for surrender pursuant to an offer such offer shall be extinguished and no longer be available for the purposes of this paragraph 2.10.

2.10.12 For the purposes of this paragraph 2.10:

- (a) the "**available surrender rate**" in relation to an Aggregate System Entry Point is the rate (in kWh/hour) calculated as an amount of Firm System Entry Capacity equal, as appropriate, to the Firm Capacity Shortfall, divided by the number of hours remaining in the Day following the capacity selection effective time;
- (b) the "**capacity selection effective time**" is the hour bar following the next hour bar falling after the end of a capacity selection period;
- (c) the "**implied surrender rate**" in relation to:
 - (i) a fixed offer, is the rate (in kWh/hour), calculated as the amount of Firm System Entry Capacity in respect of which the offer was made divided by the number of hours remaining in the Day were Firm System Entry Capacity to be selected for surrender pursuant to such offer;
 - (ii) a reducing offer, is the rate (in kWh/hour) calculated as the amount of Firm System Entry Capacity in respect of which the offer was made divided by the number of hours remaining in the Day from the hour bar following the hour next falling after submission of such offer.

2.11 Capacity Charges and Capacity Surrender Charges

2.11.1 A User shall pay Capacity Charges ("**System Entry Capacity Charges**") in respect of its Registered System Entry Capacity at Aggregate System Entry Points.

2.11.2 The System Entry Capacity Charge payable by a User in respect of each Day will be determined for each Aggregate System Entry Point and each class (as described in paragraph 2.1.4) of System Entry Capacity, as the amount of the User's Registered System Entry Capacity (of the relevant class, and in the case of Quarterly System Entry Capacity and Monthly System Entry Capacity, applied for pursuant to paragraphs 2.2 and/or 2.3, and allocated following an invitation date) multiplied by the Applicable Daily Rate.

2.11.3 The Applicable Daily Rate shall be:

- (a) in respect of Quarterly System Entry Capacity applied for pursuant to an annual invitation under paragraph 2.2, the applicable reserve or cleared price (for the calendar quarter) as determined following the relevant annual invitation date in accordance with paragraph 2.6;
- (b) in respect of Monthly System Entry Capacity applied for pursuant to an invitation under paragraphs 2.2 and 2.3, the bid price tendered by the User in respect of the Monthly System Entry Capacity allocated for the relevant calendar month pursuant to paragraph 2.7.2;
- (c) in respect of Daily System Entry Capacity, the bid price tendered by the User in respect of the Daily System Entry Capacity allocated for the Day pursuant to paragraph 2.7.2; and
- (d) in respect of Daily Interruptible System Entry Capacity, the bid price tendered by the User in respect of the Daily Interruptible System Entry Capacity allocated for the Day pursuant to paragraph 2.7.2.

2.11.4 For the purposes of paragraph 2.11.2, the amount of the User's Registered System Entry Capacity shall be determined Adjusted pursuant to paragraph 2.9.4 (but for the avoidance of doubt Unadjusted pursuant to paragraphs 2.8.4 and 2.10.7).

2.11.5 Where Transco accepts a daily capacity offer pursuant to paragraph 2.10 Transco will pay to the User a charge ("**Capacity Surrender Charge**") in an amount determined as the amount of System Entry Capacity for which the daily capacity offer was accepted by Transco multiplied by the offer price specified in the daily capacity offer.

2.11.6 System Entry Capacity Charges and Capacity Surrender Charges will be invoiced and payable in accordance with Section S.

2.12 Overrun charges

2.12.1 If for any reason the quantity of gas delivered by a User to the System at an Aggregate System Entry Point on any Day exceeds the User's aggregate Available System Entry Capacity (determined as Fully Adjusted), the User shall pay a charge ("**System Entry Overrun Charge**") in respect of System Entry Capacity at that Aggregate System Entry Point on that Day.

2.12.2 For the purposes of this paragraph 2.12, in respect of a User at an Aggregate System Entry Point for any Day, the "**overrun quantity**" is the amount by which the sum of

the User's UDQIs on that Day in respect of each System Entry Point comprised in the Aggregate System Entry Point exceeds the sum of the User's Fully Adjusted Available System Entry Capacity.

2.12.3 The System Entry Overrun Charge shall be calculated as the amount of the overrun quantity multiplied by whichever is the greatest of:

- (a) $(8 * A)$, where 'A' is the highest bid price in relation to a capacity bid in respect of which System Entry Capacity was allocated following an invitation under paragraphs 2.2, 2.3 and 2.4; and
- (b) $(1.1 * B)$, where 'B' is the relevant average accepted offer price;
- (c) $(1.1 * C)$, where 'C' is the relevant average accepted forward price; and
- (d) $(1.1 * D)$, where 'D' is the relevant average accepted exercise price,

where (a), (b), (c) and (d) are calculated by reference to information available to Transco at 02:00 hours on the relevant Day.

2.12.4 For the purposes of paragraph 2.12.3(b), in respect of an Aggregate System Entry Point the “**relevant average accepted offer price**” for a Day is calculated as:

$$\left[\frac{1}{n} \sum_{i=1}^n \frac{Q_i}{Q} P_i \right]$$

where:

n is the number of relevant successful offers;

Q is the amount of Daily System Entry Capacity surrendered pursuant to each relevant successful offer (being in aggregate equal to the relevant capacity); and

P is the offer price of each relevant successful offer,

and for the purposes of this paragraph 2.12.4 a “**relevant successful offer**” is an offer in respect of which relevant capacity was surrendered by a User and “**relevant capacity**” is that amount of System Entry Capacity equal to the first 25% of the total Firm System Entry Capacity surrendered by Users (determined by ranking all relevant successful offers for the Day in price order (the highest ranked first) and aggregating the Firm System Entry Capacity surrendered for each relevant successful offer, in descending order of bid price starting with the highest priced until the aggregate Firm System Entry Capacity surrendered equals the relevant capacity) in accordance with paragraph 2.10 and the System Management Principles.

2.12.5 For the purposes of paragraph 2.12.3(c), in respect of an Aggregate System Entry Point the “**relevant average forward price**” for a Day is calculated as:

$$\left[\frac{1}{n} \sum_{i=1}^n P_i \right]$$

where:

n is the number of relevant forward arrangements;

Q is the amount of Daily System Entry Capacity surrendered (being in aggregate equal to the relevant forward capacity) pursuant to the relevant forward arrangements; and

P is the forward price of each relevant forward arrangement,

and for the purposes of this paragraph 2.12.5 a "**relevant forward arrangement**" is a Capacity Management Agreement pursuant to which relevant forward capacity was surrendered by a User for the relevant Day on any earlier Day and "**relevant forward capacity**" is that amount of System Entry Capacity equal to the first 25% of Firm System Entry Capacity surrendered by Users (determined by ranking all relevant forward offers for the Day in price order (the highest ranked first) and aggregating the Firm System Entry Capacity surrendered for each relevant forward offer, in descending order of bid price starting with the highest priced until the aggregate Firm System Entry Capacity surrendered equals the relevant forward capacity) in accordance with paragraph 2.10 and the System Management Principles.

2.12.6 For the purposes of paragraph 2.12.3(d), in respect of an Aggregate System Entry Point the "**relevant average accepted exercise price**" for a Day is calculated as:

$$[]$$

where:

n is the number of relevant option arrangements;

Q is the amount of Daily System Entry Capacity surrendered (being in aggregate equal to the relevant option capacity) pursuant to the relevant option arrangements; and

P is the exercise price of each relevant option arrangement,

and for the purposes of this paragraph 2.12.5 a "**relevant option arrangement**" is a Capacity Management Agreement pursuant to which relevant option capacity was surrendered by a User for the relevant Day on any earlier Day following the exercise by Transco of an option that System Entry Capacity be surrendered on such Day and "**relevant option capacity**" is that amount of System Entry Capacity equal to the first 25% of Firm System Entry Capacity surrendered by Users (determined by ranking all relevant option offers for the Day in price order (the highest ranked first) and aggregating the Firm System Entry Capacity surrendered for each relevant option offer, in descending order of bid price starting with the highest priced until the aggregate Firm System Entry Capacity surrendered equals the relevant option capacity) in accordance with paragraph 2.10 and the System Management Principles.

2.12.7 Where on any Day Transco makes a Constrained Storage Renomination in respect of the Storage Connection Point of an LNG Facility then, subject to the proviso below, the System Entry Overrun Charge for a User in respect of that LNG Facility shall be zero for any overrun quantity but only to the extent and for such part of that Day that the implied rate derived from the Constrained Storage Renomination exceeds the implied rate derived from that User's Registered Storage Deliverability (as defined in Section Z) (in both cases for that LNG facility). This paragraph shall only apply in respect of a User where that User sends written notification to Transco within three Business Days of the relevant Day stating (a) that the zero rate is to apply; (b) the overrun quantity and the period for which it is to apply; and (c) reasonable evidence to support its claim.

2.12.8 System Entry Overrun Charges shall be invoiced and payable in accordance with Section S.

2.13 Capacity Neutrality Arrangements

2.13.1 For each Aggregate System Entry Point the difference between amounts received or receivable and paid or payable by Transco in respect of Relevant Capacity Charges and certain other amounts in respect of each Day in a calendar month shall be payable to or recoverable from relevant Users (and such amount shall not be reduced by any amount to be retained or borne by Transco).

2.13.2 For each Aggregate System Entry Point, in relation to each Day:

(a) **"Relevant Capacity Revenues"** are the aggregate of the amounts payable to Transco by Users:

(i) by way of Capacity Charges in respect of:

- (1) Daily System Entry Capacity where the User was registered as holding the Daily System Entry Capacity for the Day with effect from the start of the Day or at any time during the Day;
- (2) Daily Interruptible System Entry Capacity; and
- (3) any additional Firm System Entry Capacity made available by Transco (as determined by Transco acting in its sole discretion) in excess of, and not comprising (for the avoidance of doubt), Unsold System Entry Capacity,

at the Aggregate System Entry Point;

(ii) System Entry Overrun Charges; and

(iii) where any User has negative Available System Entry Capacity, by way of System Entry Overrun Charges pursuant to (and calculated in respect of the amount determined under) paragraph 5.5.2(ii);

in respect of such Day;

(b) **"Relevant Capacity Costs"** are the aggregate of the amounts payable by Transco to Users by way of:

(i) Capacity Management Charges (for which purposes any premium payable by Transco shall be attributable to the Day pro rata to the number of Days during which Transco may exercise rights in respect of the surrender of Firm System Entry Capacity pursuant to the relevant Capacity Management Agreement); and

(ii) Aggregate Constraint Amounts pursuant to Section I3.7.2,

in relation to the Aggregate System Entry Point in respect of such Day.

2.13.3 In relation to each Aggregate System Entry Point and a calendar month, Transco shall pay to each relevant User an amount ("**Capacity Revenue Neutrality Charge**") determined as:

$$\text{RCR} * \text{UFAC} / \text{AFAC}$$

where:

RCR is the Relevant Capacity Revenues;

UFAC is the aggregate sum of the User's Fully Adjusted Firm Available System Entry Capacity at each Aggregate System Entry Point; and

AFAC is the aggregate sum of all Users' Fully Adjusted Firm Available System Entry Capacity at each Aggregate System Entry Point,

in each case as determined at 04:00 hours on the relevant Day.

2.13.4 In relation to each Aggregate System Entry Point and a calendar month, each relevant User shall pay to Transco an amount ("**Capacity Cost Neutrality Charge**") determined as:

$$\text{RCC} * \text{UFAC} / \text{AFAC}$$

where:

RCC are the Relevant Capacity Costs,

and 'UFAC' and 'AFAC' have the meanings in paragraph 2.13.3.

2.13.5 For the purposes of this paragraph 2.13:

(a) the "**Second Capacity Adjustment Neutrality Amount**" for a Day in a calendar month (month 'm') is

(i) the sum of:

(1) the amount of any charge of a kind referred to in the definition of Relevant Capacity Revenues, and of any Capacity Neutrality Charge (payable to Transco), which was due for payment to Transco in month m-2 but was unpaid to Transco as at the last Day of month m:

(2) the amount of any interest paid (in accordance with Section S4.3.2) by Transco to any User on any Day in month m by virtue of the User having made an over-payment in respect of any of such amount as is referred to in paragraph (1) above;

less

(ii) the sum of:

(1) the amount of any charge of a kind referred to in the definition of Relevant Capacity Revenues, and of any Capacity Neutrality Charge (payable to Transco) which:

(A) was unpaid as at the last Day of month m-3 and was taken into account (under paragraph (a)(i) above) in calculating the Second Capacity Adjustment Neutrality Amount for month m-1, but

(B) has been paid to Transco since the last Day of month m-1;

(2) the amount of any interest paid (in accordance with Section S4.3.2) by any User to Transco on any Day in month m by virtue of late payment of any such charge as is referred to in paragraph (1) above,

divided by the numbers of Days in calendar month 'm';

- (b) "**Capacity Neutrality Charges**" comprise Capacity Revenue Neutrality Charges, Capacity Cost Neutrality Charges and Capacity Adjustment Neutrality Charges;
- (c) "**Relevant Capacity Charges**" comprise Relevant Capacity Revenues and Relevant Capacity Costs; and
- (d) a "**relevant User**" is a User registered as holding Firm System Entry Capacity at an Aggregate System Entry Point on the relevant Day.

2.13.6 In relation to a Day (and all Aggregate System Entry Points), where:

- (a) the Second Capacity Adjustment Neutrality Amount (if any) is negative, Transco shall pay to each relevant User; and
- (b) the Second Capacity Adjustment Neutrality Amount (if any) is positive, each relevant User shall pay to Transco,

an amount ("**Capacity Neutrality Adjustment Charge**") determined as:

$$\text{CNA} * \text{UFAC} / \text{AFAC}$$

where CNA is the Second Capacity Adjustment Neutrality Amount and 'UFAC' and 'AFAC' have the meanings in paragraph 2.13.3 (provided that in the event that no Firm System Entry Capacity was held by any User at any Aggregate System Entry Point on such Day, 'UFAC' and 'AFAC' shall be determined on the basis of the most recent preceding Day in respect of which a User held Firm System Entry Capacity at an Aggregate System Entry Point).

2.13.7 Capacity Neutrality Charges shall be invoiced and payable in accordance with Section S.

2.14 Auction information

2.14.1 In respect of each annual invitation pursuant to paragraph 2.2.2(b), Transco will by not later than 20:00 hours on each invitation date (under paragraph 2.2.3(b)) notify Users, in respect of each Aggregate System Entry Point and each relevant long term period, of the cumulative amounts of Quarterly System Entry Capacity in relation to which Users have in aggregate submitted Quarterly capacity bids at each price step on such and earlier annual invitation dates for each relevant Gas Year.

2.14.2 Following each allocation of System Entry Capacity pursuant to paragraphs 2.2, 2.3, 2.4 and 2.5 Transco will, in accordance with paragraphs 2.6.7 and 2.7.7 and in respect of each Aggregate System Entry Point and relevant long term period or (as the case may be) relevant short term period, notify Users of:

- (a) the price (in pence/kWh) accepted for System Entry Capacity by a User (and the amount of System Entry Capacity applied for);
- (b) the relevant step price group;
- (c) the lowest accepted bid price in respect of a successful capacity bid and the amount of System Entry Capacity applied for;
- (d) aggregate volume of System Entry Capacity allocated to successful capacity bids;
- (e) the number of Users who submitted successful capacity bids and the number of Users who submitted unsuccessful capacity bids;
- (f) the weighted average price in respect of capacity bids for which System Entry Capacity was allocated calculated as:

[]

where:

- n is the number of successful relevant capacity bids;
- Q is the amount of System Entry Capacity allocated to each successful relevant capacity bid; and
- p is the bid price of each successful relevant capacity bid,

and for the purposes of this paragraph 2.14.2(f), "**relevant capacity bid**" is a bid in respect of which relevant capacity was allocated and "**relevant capacity**" is that amount of capacity equal to the first 50% of the total System Entry Capacity allocated (determined in accordance with the the provisions of paragraphs 2.6.2 or 2.6.6 or (as the case may be) paragraph 2.7.2;

- (g) the amount of Baseline Entry Capacity which remains unsold (if any) following the allocation; and
- (h) in the case of an allocation of Quarterly System Entry Capacity only, the number of Users who submitted, in respect of each step price group, a Quarterly capacity bid."

[Amend paragraph 3.5.1 to read as follows:

"

(i)

(ii)on any Day or a charge payable by reference to the arrangements in Special Condition [28B] of the Transco Licence."]

SECTION I: ENTRY REQUIREMENTS

Amend text at paragraph 3.7.1 to read as follows:

“.....as Adjusted pursuant to Sections B2.10.8

Amend text at paragraph 3.7.2 to read as follows:

"

Xtpursuant to Section B2.10.8;

....

R1where ADR is the Applicable Daily Rate determined as the weighted average price of Quarterly System Entry Capacity and Monthly System Entry Capacity in respect of capacity bids for which System Entry Capacity was allocated calculated as:

[]

where:

n is the number of successful relevant capacity bids;

Q is the amount of System Entry Capacity allocated to each successful relevant capacity bid; and

p is the bid price of each successful relevant capacity bid,

and for the purposes of this paragraph I.3.7.2, "**relevant capacity bid**" is a bid in respect of which relevant capacity was allocated and "**relevant capacity**" is that amount of capacity equal to the first 50% of the total System Entry Capacity allocated (determined in accordance with the provisions of paragraphs 2.6.2 or 2.6.6 and paragraph 2.7.2;

F2 is one decimal four (1.4),

and for purposes of determining the aggregate notional surrender costs on a Day in respect of an Aggregate System Entry Point, such costs shall include the exercise price (in pence/kWh/Day) payable by Transco pursuant to a Capacity Management Agreement were Transco to exercise its rights there under) in respect of the surrender of System Entry Capacity on such Day but shall not include any costs payable by Transco pursuant to the Capacity Management Agreement by way of a premium and which for any other purpose under the Code is determined as attributable to such Day)."

Amend text at paragraph 3.7.3 to read as follows:

".....

U”pursuant to Section 2.10.8, “.....

A”pursuant to Section B.2.8.4, B.2.9.4 and B.2.10.8 held by Users at the “...

Amend text at paragraph 3.7.4 to read as follows:

“ADQ1” and for the purposes of Section B.2.13 the “.....

SECTION W: INTERPRETATION

Add, at appropriate alphabetical position in paragraph 1, text to read as follows:

""Incremental Entry Capacity Release Statement" is the statement prepared and published by Transco in accordance with Special Condition 34 of the Transco Licence;"

"System Management Principles" are the principles and criteria established and published by Transco pursuant to Special Condition 27(5) of the Transco Licence for the purposes of (inter alia) Capacity Management;"

At paragraph 2.2.1 add new paragraph (j) to read as follows:

""Formula Year" means the period from 1 April in any year until and including 31 March in the following year."

TRANSITION DOCUMENT PART II

Add new paragraph 8.1.15 to read as follows:

"8.1.15 B2.2 (1) Users may have made applications and be registered as holding Monthly System Entry Capacity for each calendar month in Gas Year + 1 (2002/2003) in accordance with paragraph 8.1.3 of this Part II.

(2) Users may make applications for Monthly System Entry Capacity for each calendar month in Gas Year + 2 (2003/2004) pursuant to an invitation to be held by Transco, for which purposes:

(a) the provisions of Section B2 ("**Old Section B2**") which applied immediately prior to the date on which the Modification giving effect to this paragraph had effect shall continue to apply (except as provided for otherwise in paragraph (b));

(b) the provisions of paragraph 8.1.3 of this Part II in respect of Old Section B2 shall apply for which purposes Transco's invitation shall:

(i) be in respect of each of the calendar months October 2003 to March 2004 (inclusive); and

(ii) shall specify four dates, the last of which shall be not later than 31 August 2003,

and the System Entry Capacity which Users may be registered as holding following such invitation in respect of a calendar month shall be Monthly System Entry Capacity.

(3) Users may make applications for Quarterly System Entry Capacity for each calendar quarter in Gas Year + 3 (2004/2005) to Gas Year + 15 (2016/2017) (inclusive) pursuant to an annual invitation to be held not earlier than 1 January 2003 and not later than 31 January 2003.

(4) In determining the amount of Unsold System Entry Capacity for each Day in a calendar month in Gas Year + 1 (2002/2003) and Gas Year

+ 2 (2003/2004) for the purposes of a rolling monthly invitation in respect of each such calendar month account shall be taken of the Monthly System Entry Capacity previously made available to and held by Users in relation to such calendar month pursuant to paragraph 8.1.3 of this Part II or (as the case may be) paragraph (2).

- (5) References to a Gas Year + n in paragraphs (1), (2), (3) and (4) shall be interpreted as if the relevant invitation had taken place in Gas Year 2001/2002."

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 **0500**, version **3.0** dated **30/09/2002**) 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 **3.0**.

Signature:

Process Manager - Network Code
Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.