URGENT Modification Report
Fifth Round Monthly System Entry Capacity Allocation
Modification Reference Number 0480

Version 2.0

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

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because any changes to the structure of the NTS Entry Capacity auction regime will need to be made in a timely manner prior to 13 August 2001, the scheduled commencement date of the auctions for Entry Capacity over the period 1 October 2001 and 31 March 2002. Provision of Urgent status should allow Transco time to issue an amendment to its invitation to the auction and provide sufficient time for shippers to amend their bidding strategies if the proposal is accepted.

Procedures Followed:

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

Issued to Ofgem for decision on urgency	16 July 2001
Proposal agreed as Urgent	17 July 2001
Proposal issued for Consultation	17 July 2001
Close out for Representations	23 July 2001
Final Report to Ofgem	25 July 2001
Ofgem Decision Expected	27 July 2001

1. The Modification Proposal

This Modification Proposal is intended to increase the level of competition for Monthly System Entry Capacity (MSEC). In particular it will enable larger quantities to be offered in what is known as the 5th round of MSEC auctions. The proposal below implies a change to the method of calculating Determined System Entry Capacity or Available Monthly Capacity with respect to each Aggregate System Entry Point (ASEP).

It is proposed that the current published volumes of Determined System Entry Capacity be offered in equal sized tranches for rounds 1 to 4 of the MSEC auctions.

That the volumes be increased to SND + 20% (from the published SND + 10%) and that the incremental volume be added to any quantities remaining unsold from the preceding auction rounds and will be offered in round 5.

The Network Code rules for operating round 5 will remain unchanged from the present arrangements in all other respects. Shippers will consequently be afforded an opportunity to bid for a greater proportion of Determined System Entry Capacity through round 5.

2. Transco's Opinion

Transco does not support this Modification Proposal. It believes that an increase in the volume of capacity released to SND +20% could increase the likelihood of capacity constraints and reduce the potential for incremental sales of entry capacity. Taken together this would present a substantial change to the risk / reward profile for both Transco and shippers via the capacity incentive. Transco accepts that this could be mitigated by a re-assessment of the format of the capacity incentive but would argue that there is not sufficient time to carry this out before the start of the next set of entry capacity auctions on 13 August 2001.

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

In the proposer's view, the allocation of a larger proportion of capacity through a competitive fifth round could further the economic and efficient operation of the system as it would enable increased quantities to be allocated to ASEPs in line with Users' commercial requirements. However, some respondents have suggested that there would be a greater probability of buy back of entry capacity, which would reduce certainty for holders of daily firm capacity and increase buy back costs to the industry. Both of these potential outcomes would be unlikely to further the efficient and economic operation of the system.

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

a) implications for the operation of the System:

No implications for the operation of the System are envisaged. Although the proposal would increase the total volume of capacity released across all ASEPs the capacity available at an individual ASEP would not be higher than the maximum deliverability of that ASEP under SND conditions.

b) development and capital cost and operating cost implications:

No implications for development, capital or operating costs are envisaged were this Modification Proposal to be implemented.

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:

Not applicable.

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

Not applicable.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

Transco considers that a change in the level of contractual risk under the Network Code is possible because increased release of MSEC would increase the risk of buy back.

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

Implementation of this Modification Proposal would have no development implications for the computer systems of Transco.

Transco is unaware of any development implications for the related computer systems of Users.

7. The implications of implementing the Modification Proposal for Users

If the proposal is implemented Users would have a greater opportunity to acquire capacity in the fifth round of the MSEC auction. Users would need to assess the impact of this change to the auction regime on their bidding strategies for the forthcoming NTS Entry Capacity auctions, which are due to commence on 13 August 2001.

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

Transco does not envisage any implications of implementing the Modification Proposal for the above parties.

9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

No consequences are envisaged on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party as a result of implementing the Modification Proposal.

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

Advantages :

The allocation of capacity to each ASEP would be carried out with reduced reliance on historical gas flow information.

The proposal would enable more capacity to be offered.

Disadvantages :

The proposal adds a degree of uncertainty in the run up to the next NTS Entry Capacity auctions. Shippers would need to account for the late change in the structure of the auction and amend their bidding strategies accordingly.

There would be a greater probability of the buy back of entry capacity being required where increased MSEC capacity leads to nominations and/or gas flows at levels beyond physical flow capability. Risks are also increased of demand for coincident high flows at competing ASEPs, which may trigger further requirements for interruptible scale back and firm buy back.

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

Representations have been received from the following parties :

Exxon Mobil Gas Marketing (Exxon Mobil)
Scottish and Southern Energy (SSE)
Shell Gas Direct Limited (SGD)
TXU Europe Energy Trading Limited (TXU)
TotalFinalElf Exploration UK PLC (TFE)
TotalFinaElf Gas and Power UK Limited (TFEG&P)
Alliance Gas Limited (AGL)
Conoco (UK) Limited (Conoco)
Northern Electric and Gas Limited (NEAGL)
Chevron UK Limited
Powergen
British Gas Trading (BGT)

Four respondents (BGT, AGL, Chevron and SSE) express support for the Modification Proposal. They argue that, in contrast to Modification Proposal 0477, it would increase the volume of capacity available in the fifth round without reducing capacity availability in the first four rounds and would therefore weaken the perception that there is a shortage of entry capacity, a factor that could encourage price escalation. Both Chevron and SSE also comment that this could improve the availability of OTC capacity. Chevron also considers that the proposal would bring advantages as it would decrease the reliance on historic gas flows as a way of allocating capacity between ASEPs.

BGT disputes a statement made by Transco at an RGTA meeting that the proposal would not increase the total amount of capacity offered at St. Fergus. BGT argues that if the aggregate quantity released is increased to SND +20% the ASEP maximum should also increase up to the limit of the ASEP physical capacity.

SSE expresses support for the proposal and believes that it could have a positive impact on bidding behaviour. However, it also stresses that it has a number of concerns that should be addressed as soon as possible. SSE notes that the proposal could result in Transco overselling entry capacity and it highlights implications that could arise as a result of this, including a possible increased risk of buy back, greater interruption of Interruptible Entry Capacity and a decrease in the amount of incremental capacity that could be made available as firm at the day ahead / within day stages. SSE also notes that increased levels of buy back would have an impact on Transco's capacity incentive balance and represent an increased risk to Users, which would incur 80% of buy back costs.

SSE also warns that there could still be an incentive for Users to "bid up" in early auction rounds, as the additional amount of capacity would not be released until the fifth round and Users may not be prepared to risk waiting until this round to secure their firm capacity requirements.

The majority of respondents (Exxon Mobil, SGD, TXU, TFE, TFEG&P, Conoco, NEAGL, Powergen) are not in support of the Modification Proposal.

Exxon Mobil, TXU, TFE, TFEG&P and Conoco consider the proposal would only result in a marginal improvement on the current methodology, as the quantities of capacity available at each ASEP would continue to be capped by the determination of the Maximum Capacity Amount at a particular ASEP. TXU believes that the additional capacity would not be of benefit to any terminals where there is a high demand for capacity. Conoco does not agree that the proposal would increase competition at "non competitive" terminals. Instead, it argues that the proposal would be likely to increase the aggression of competition at the more competitive and constrained terminals like St. Fergus.

SGD believes that the proposal does not address the fundamental concerns relating to the auction regime and until this is done it considers that there is no reason for any further change. TFE and TFEG&P consider that any proposal raised to address the issue of over recovery of revenue would need to directly introduce additional entry capacity above the current maximum MSEC figures published by Transco. TFEG&P considers that until sufficient capacity is released to satisfy the perceived forward looking demand there will continue to be an upward pressure on the prices bid for capacity in the auction, especially at St. Fergus. Conoco agrees with this sentiment and believes that carrying out an auction under the present circumstances, where there is a perception of restrictive capacity volumes, would lead to an upward spiral in bid prices and a further over recovery of revenue.

SGD and TFE consider that the proposal has some merits over Modification 0477 in that it would not send a signal to the market that too little capacity is available across all terminals. However, like SSE, SGD is also of the opinion that the overselling of capacity implied by the proposal could lead to an increased risk of buy back or increased use of Terminal Flows Advice. NEAGL also states that it could not support any change to the regime that could increase the probability of buy back and increase the risks to MSEC holders. NEAGL comments that the "arbitrary nature" of an SND +20% methodology does not address the individual capacity capability of each ASEP. However, the increased risk of buy back would be borne by all MSEC holders on a non ASEP specific basis.

Powergen also considers that the proposal would significantly increase the probability of buy back, particularly at St. Fergus and "could even undermine the firmness of MSEC at certain ASEPs". Powergen does not believe that this would be desirable and instead, expresses a preference for Transco to aim to match the amount of MSEC sold at a terminal to its ability to make available such capacity at a given time of year, with the within day mechanism being used to "fine tune" capacity to reflect demand levels.

Powergen also requests confirmation of why the quantity of capacity made available at St. Fergus in October 2001 is lower than the quantity made available for October 2000. Powergen notes that Transco has previously advised that this is a result of the level of buy backs experienced in October 2000. However, it disputes that the methodology for deriving the MSEC allocated to each ASEP should take account of such adjustments and suggests that, rather than making unilateral adjustments to MSEC levels, Transco should specifically discuss any concerns over the level of potential buy back at an ASEP in a consultation on the methodology for deriving MSEC values.

SSE and NEAGL raise concerns that the proposal has been raised so close to the start of the forthcoming Entry Capacity auctions, particularly in light of the fact that many Users had stressed during the consultation for Modification Proposal 0465 (Amendments to the NTS Entry Capacity Auction Period) that there should be a one month period between the date of publication of Entry Capacity quantities and the commencement of the auctions. SSE and NEAGL comment that this proposal now means that there is considerable uncertainty in understanding the nature of the products being auctioned and their relative values, which could have an impact on bidding strategies.

Transco Response

Transco agrees with those respondents who do not support implementation of this proposal. Transco shares the concerns of respondents that an increase release of MSEC would change demand for daily capacity and increase the possibility of buy back. Taken together these represent a material change to the capacity incentive, to which both shippers and Transco are exposed.

Transco had sought to explain at the Energy and Capacity Workstream meeting of 5 July 2001 the process of calculating the MSEC to be offered at each entry point. The major effects upon capacity allocation for winter 2001/2002 are a low growth in Seasonal Normal Demand and expectations of peak deliverability at each ASEP. Peak deliverability in this case is drawn from the Base Planning Process, and in addition a three year profile is reflected at each ASEP. Taken together these effects have generated a lower MSEC quantity in October 2001 than for the corresponding period of the previous year.

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 facilitate compliance with safety or other 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

Not applicable.

14. Programme of works required as a consequence of implementing the ModificationProposal

As no changes are required to the UK-Link systems a programme of works would not be required as a consequence of implementing the Modification Proposal.

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

An Ofgem decision on the proposal is expected on 27 July 2001. If the proposal is approved on this date Transco would suggest an implementation date of 31 July 2001.

16. Recommendation concerning the implementation of the Modification Proposal

Transco does not recommend that this Modification Proposal is implemented.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

19. Text

No legal text is provided as Transco is not in support of this Modification Proposal.

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 **0480**, version **2.0** dated **25/07/2001**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **2.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:

   (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or

   (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

   provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.

2. If the Authority does so approve this Agreement in accordance with the terms of the Order <u>(whether such approval is actual or deemed by effluxion of time)</u> 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, <u>had it not been repealed, would</u> 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) <u>or 2(2)(b)(ii)</u> 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.