

Direct Dial: 020-7901 7327

24 August 2001

Transco, Shippers and Other Interested Parties

Our Ref: Net/Cod/Mod/0489

Dear Colleague,

Modification Proposal 0489 'Revision to NTS entry capacity auction timetable 2001'

Ofgem has carefully considered the issues raised in Modification Proposal 0489 '*Revision to NTS entry capacity auction timetable 2001*'. Ofgem has decided not to direct Transco to implement this modification, because we do not believe that this proposal will better facilitate the relevant objectives of Transco's Network Code.

In this letter, we explain the background to the issues raised in the modification proposal and give the reasons for making our decision.

Background to the proposal

In September 1999, Transco conducted the first auctions for the sale of entry capacity to its National Transmission System ('NTS'). The auctions provided for the allocation of firm monthly system entry capacity (MSEC) to successful bidders for a total period of six months from 1 October 1999 to 31 March 2000. Further series of auctions were held in March 2000, August 2000 and February 2001.

In addition to conducting MSEC auctions, Transco conducts monthly interruptible system entry capacity (MISEC) auctions. The first of these auctions was held in November 2000 for a period of four months from December 2000 to March 2001 and a further set of auctions was conducted in March 2001 for the six-month period April to October 2001.

To date, each series of auctions has been the subject of delays when compared to the original timetable agreed for holding the auctions. These delays are largely attributable to proposals that have been raised to modify the capacity regime in the period

immediately prior to the commencement of the auctions. Ofgem, Transco, shippers and customers have all expressed concern about repeated delays in the auction timetable and the additional uncertainty this can cause. However, regrettably, during each series of auctions to date, modification proposals have been raised to address issues with the current arrangements close to the proposed auction date. In each instance, a balanced decision has had to be taken about whether to delay the auctions to allow shippers and other interested parties to understand the impact of any modifications prior to the commencement of bidding.

On 27 June 2001 Ofgem accepted modification proposal 0465, *'Amendments to the NTS Entry Capacity Auction Period'*. This modification provided that the forthcoming series of entry capacity auctions (both MSEC and MISEC) would cover the six-month period 1 October 2001 to 31 March 2002. In addition, the modification provided that auctions for MSEC are due to be completed prior to the commencement of the MISEC auctions. In order to enable this change, the modification provided that the MSEC auctions were due to be completed by 31 August and the MISEC auctions by 15 September 2001. The scheduled commencement date for the MSEC auctions was 13 August 2001.

On 29 June 2001, following Ofgem's acceptance of modification 0465, Transco issued its invitation to shippers for the six month auctions from 1 October 2001 to 31 March 2002. This invitation included the quantities of MSEC to be made available to shippers in the auction. Following the release of these quantities a number of shippers raised concerns regarding the volume of capacity to be auctioned. Subsequently three modifications were raised in response to these concerns, namely modification proposal 0477, *'Fifth Round Monthly System Entry Capacity Allocation'*, modification proposal 0480, *'Fifth Round Monthly System Entry Capacity Allocation'*, and modification proposal 0481, *'Release of ASEP Maximum System Entry Capacity Volumes for MSEC Auction'*.

In order to allow participants in the auctions time to properly assess the impact of these proposals and review their bidding strategies, Transco raised modification proposal 0482, *'Revision to NTS entry capacity auction timetable 2001'* to further delay the winter auctions. The modification proposed delaying the commencement of the auction from 13 August 2001 to 29 August 2001. Transco subsequently raised a further proposal; modification proposal 0483, *'Monthly System Entry Capacity Auction Quantity Revision and Capacity Incentive Adjustment'*, which concerned the allocation of capacity offered in the fifth round to different Aggregate System Entry Points and Transco's daily capacity incentive. In addition, Transco also issued a Pricing Consultation, PC 65, *'Alternative Method of Funding Entry Capacity Constraint Management'* which provided for the creation of a fund drawn from monthly auction income to fund the costs of daily capacity buy-backs.

Ofgem issued its decisions on modification proposals 0477, 0480 0481 and 0483 on 9 August 2001, accepting modification 0481 whilst rejecting modifications 0477, 0480 and 0483. Modification 0481 provided for the release of increased volumes of capacity in the MSEC auctions. Ofgem also accepted modification 0482 on 9 August 2001 delaying the commencement of the capacity auction to allow shippers additional time to consider the changes to the regime.

Following Ofgem's acceptance of modification proposal 0482 Transco raised a further Pricing Consultation, PC 66, *'Transportation Charge Adjustments Following Entry Capacity Auctions'*, which provides for an amendment to the current revenue adjustment mechanism in the event of an auction under recovery. In addition, to this pricing consultation Transco raised a further modification proposal 0488, *'Redesign of capacity incentive regime'*, that proposes the introduction of a revised capacity incentive. The purpose of this proposal is to address a change in the perceived risks and rewards under Transco's existing daily capacity incentive following Ofgem's acceptance of modification 0481.

Ofgem will be issuing its decisions on PC66 and modification 0488 today, along with its decision on Pricing Consultation 65, *'Alternative Method of Funding Entry Capacity Constraint Management'*.

In addition BG Gas Services has raised two modification proposals, namely modification proposal 0489, *'Revision to NTS Entry Capacity Auction timetable'*, and 0490 *'Adjustment to ASEP capacity revenue neutrality calculation'*. Modification 489 is the subject of this decision and proposes a further delay to the auctions.

Modification 490 proposes an adjustment to the mechanism by which capacity buy-back costs are apportioned between shippers. Since this modification was raised, Transco has raised an alternative proposal, namely modification proposal 0490a. This alternative proposal is intended to provide a clarification of the revised apportionment mechanism proposed by BG Gas Services in modification proposal 490. Ofgem has today issued its decisions on modification proposals 490 and 0490a.

The modification proposal

The modification proposes to delay the start date for the forthcoming MSEC auctions from 29 August to 4 September 2001. Under this proposal the MSEC auctions will be completed by 14 September. The proposal makes no change to the dates of the MISEC auctions, which would continue to be 12 and 14 September 2001. The proposal

suggests that the MISEC auctions could be held on the 17 and 19 September 2001 if Network Code changes make this easier than holding two different auctions on the same day.

Respondents' views

The overwhelming majority of respondents opposed this modification.

A number of respondents noted that further delays to the auction timetable could lead to shippers raising additional urgent modifications proposing further changes to the regime. Respondents have also expressed disappointment at the number of recent modifications raised in the period just before the commencement of the next set of auctions.

Some respondents indicated that these modifications may contribute to increased uncertainty and price volatility in the auctions. In this respect one shipper noted that more effort should have been made to prepare for the auctions in order to pre-empt the modifications and pricing consultations that have been raised.

In addition, a number of respondents argued that the MISEC auctions should not occur on the same days as the MSEC auctions. These respondents contended that the MISEC auctions should commence once the MSEC auctions have been completed, on the basis that this allows shippers to adjust their bidding strategies with the knowledge of their position in the MSEC auctions.

One respondent offered no support for the modification on the basis that shippers are more likely to make inefficient bids based on poor information, exacerbated by lack of time to analyse changes to the Network Code and pricing framework. This respondent went on to note that delaying the auctions would further reduce the notice period for changes in transportation charges. Another respondent argued that alterations to the capacity incentive regime and the buy back regime are not relevant to bidding strategies. This respondent suggested that it would be of great concern to the industry if decisions on these changes are factored into bid prices in the capacity auctions.

The few respondents in favour of modification 0489 did so on the basis that delaying the commencement of the auctions would allow shippers additional time to review the impact of outstanding decisions with respect to the auction regime. One shipper indicated that a delay would allow the industry additional time to consider modifications 0490 and 0490a.

Transco's view

Transco acknowledged the view that the auctions should proceed in accordance with the current timetable and noted the concerns put forward by respondents regarding continuing uncertainty.

Ofgem's View

Ofgem continues to believe that as a matter of principle, it would be desirable for the MSEC auctions to be held in advance of actual gas flows against acquired capacity holdings. This would give shippers sufficient time to adjust capacity holdings in secondary markets following the completion of Transco's primary auctions. In future, Ofgem would urge shippers and Transco to raise modification proposals and pricing consultations to address any issues with the capacity regime well in advance of subsequent auctions. Ofgem considers that improved industry planning and foresight with respect to reviewing and revising the capacity regime would avert the need for the frequent delays that have occurred in the past.

In this regard Ofgem remains disappointed that Transco and/or shippers have not sought to address concerns about the current arrangements sufficiently early to allow them to be addressed well before the auctions are due to commence. In particular, many of the issues currently under consideration are not new and have been discussed on several occasions since the introduction of the New Gas Trading Arrangements.

Ofgem is satisfied, on the basis of respondents' views, that a further delay to the auctions would not better facilitate any of the relevant objectives of the Network Code. Ofgem accepts the view expressed by respondents that a further delay to the auctions could cause unnecessary disruption and could potentially contribute to ongoing uncertainty regarding the nature of the capacity regime for the forthcoming winter.

Ofgem's Decision

Ofgem is satisfied, on the basis of respondents' views, that implementation of this proposal is likely to create significant disruption for shippers in preparing for the auctions and would not better facilitate the securing of effective competition between relevant shippers and relevant suppliers.

Ofgem has decided not to consent to this modification, as we do not believe that it better facilitates the achievement of the relevant objectives as outlined under Standard Condition 7 of Transco's Gas Transporter's licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

Steve Smith
Director, Trading Arrangements