

Modification Report
Limitation on offering for sale unsold capacity
Modification Reference Number 0043

Version 3.0

This Modification Report is made pursuant to Rule 10 of the Modification Rules and follows the format required under Rule 9.6.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 10.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because it took "into account the proposer's views regarding the imminent date-related event i.e. the QSEC auctions invitation letters being issued by 19 August 2005 and also the potential commercial impacts on Transco NTS, Users and ultimately consumers as a result of potentially high buy-back costs at specific Aggregate System Entry Points."

Ofgem also considered the justification for urgency accorded "with its criteria for granting urgent status to a modification proposal. In particular, Ofgem considers that if the modification proposal was to follow non-urgent procedures, and then be subsequently approved by Ofgem, there is a risk that the market would have insufficient time to amend their procedures to comply with the modification proposal"

Procedures Followed:

The procedures agreed with Ofgem for this Proposal are:

Proposal sent to Ofgem requesting Urgency	09/08/2005
Ofgem grant Urgent status	09/08/2005
Proposal issued for consultation (2 working days)	10/08/2005
Close out of representations	12/08/2005
Urgent Modification Report issued (1 working day)	15/08/2005
Modification Panel decide upon recommendation	17/08/2005
Revised Urgent Modification Report issued to Ofgem	17/08/2005
Ofgem decision expected	18/08/2005

1. The Modification Proposal

The Proposal was as follows:

"It is proposed that Transco NTS should not be obliged under the Uniform Network Code (UNC) to make Unsold NTS Entry Capacity ("unsold capacity") available to Users at an Aggregate System Entry Point (ASEP) for each gas day within a calendar quarter which Transco NTS would otherwise release through QSEC auctions (in accordance with TPD, Section B2.2) when the following criteria are met for QSEC auctions conducted within the current formula period (ie. up to 31 March 2007):

- Transco NTS assesses there is a significant risk that it will not be able to physically deliver all or part of the unsold capacity from the capacity allocation date. This would typically be caused by the length of time required to obtain consents or construction challenges, both of which may be beyond the full control of Transco NTS; and

- Transco NTS assesses there is an expectation that previously allocated capacity at the ASEP would need to be bought back.

If such criteria are met at any ASEP for one or more calendar quarters, it is proposed that the unsold capacity is set to zero in respect of any future annual, monthly or daily capacity auctions at the ASEP for any gas day within the relevant calendar quarter(s). By way of example, this would mean that if the above criteria are met in the 2005 QSEC auction for a System Entry Point for the first 4 calendar quarters for which capacity would otherwise be made available ie. Apr 07 to Mar 08, that the unsold capacity would be set to zero for that System Entry Point in respect of the following auctions conducted during the current formula period for capacity release on any relevant gas day within the period Apr 07 to Mar 08:-

- the Annual Monthly NTS Entry Capacity (AMSEC) auction (to be conducted during Feb 06 and Feb 07);
- Rolling Monthly NTS Entry Capacity (RMSEC) auctions; and
- the Daily NTS Entry Capacity auctions

In addition

Transco NTS, in making its assessment as to whether to release unsold capacity in any auction in accordance with the above criteria, would still need to ensure that it was able to meet Special Condition C8B Part 2 paragraph 14(5)(f)(ii)(a) of its Transporters Licence to “use all reasonable endeavours to offer for sale” all obligated entry capacity. Transco NTS therefore believes that the criteria proposed to be included within the UNC when considered in combination with its Licence obligations would result in unsold capacity not being released through auctions conducted this formula period only in exceptional circumstances. It is envisaged that Transco NTS would be required to seek written permission from the Authority to not release unsold capacity. Transco NTS considers that this should mitigate industry concerns regarding the amount of discretion that Transco NTS may be perceived to be granted in not releasing unsold capacity, were this Proposal to be implemented.

Under such exceptional circumstances, Transco NTS considers that the total level of buy-back costs is likely to be higher, than would otherwise be the case, if the unsold capacity is offered for sale and would be above that considered to be efficient and economic. While Transco NTS would be partly exposed to the buy-back costs in accordance with the incentive arrangements in its Transporter’s Licence, the capacity neutrality arrangements would result in all Users funding a significant proportion of these costs, which could ultimately be passed on to consumers.

If this Proposal were to be implemented, Users would be initially notified that Transco NTS is not releasing unsold capacity for each gas day within certain calendar quarters through the annual QSEC. This would then be appropriately reflected in any future annual or monthly auction invitations relating to any gas day within such a period.

Transco NTS believes this Proposal must be implemented prior to issuing invitations for the next QSEC auction, which, in accordance with the provisions of TPD Section B2.2, must state the amount of capacity that is available for each relevant capacity year.

However, if this Proposal were not implemented in the timescales identified, Transco NTS believes it and other Users could be exposed to inefficient levels of buy-back costs, which would ultimately be borne by consumers."

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

The Proposer considered "this Proposal would, if implemented, better facilitate the following Relevant Objective as set out in its Gas Transporters Licence:

- in respect of Standard Special Condition A11 paragraph 1(a), the Proposal would better facilitate the economic and efficient operation of the NTS pipeline system by avoiding the potential increase in buy-back costs incurred by both Transco NTS and Users above that which would be considered to be economic and efficient as permitted by the Authority."

Other comments were expressed as shown in the quotations within this and other sections of this report.

SGD stated that it *"...cannot concur with Transco's assertion that avoiding potentially high buy back costs is consistent with efficiency. We consider that the major changes proposed here undermine effective competition between shippers and therefore do not further the relevant objectives of the UNC. As set out in our response to UNC0037, we consider it misleading to suggest that there is a risk to consumers of high buy back costs. This misrepresents the impact of neutrality payments on end consumer prices."*

SSE stated that *"Restricting access to Unsold NTS Entry Capacity is also a barrier to new entrants and therefore detrimental to competition in shipping and supply."*

STUK stated *"As stated in our response to 0037, when the long term auctions were established in 2002 the concept of baseline capacity was created to establish the level of capacity that Transco would be required to make available up to the gas day. Further rules established that 20% of the SO Baseline capacity level should be reserved for short term release with any unsold baseline from the long term rolling into the short term auction. A mechanism was therefore established which allowed a shipper to choose between a long term product or a short term product making an assessment of the level of competition it was likely to face in each type of auction and their view of risk. In the subsequent auctions of Jan 03, Sept 03, Sept 04 shippers have chosen to participate in the long term auction based on the assumptions set out above. The withholding of unsold capacity will create barriers to new entrants into the market as well as to those participants who made the decision to not take part in the long term auctions."*

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

The Proposer did not believe this Proposal, if implemented, "would adversely impact upon security of supply or, operation of the Total System as the Proposal would not limit the availability of capacity against which Shippers Users could flow, and instead would only prevent release of capacity that is not expected to be physically available."

The Proposer also did not "consider that this Proposal would prevent timely system enhancements as it could only be utilized under exceptional circumstances under which it highly unlikely to be able to physically deliver investments under shorter timescales."

Finally, the Proposer did not "consider this Proposal would impact industry fragmentation."

Other comments were expressed as shown in the quotations within this and other sections of this report.

SSE stated that this proposal raised significant issues "*such as security of supply, the commercial impact on shippers and the ability of shippers to land gas to meet the needs of their customers.*"

In particular, SSE queried "*the impact that this proposal would have on withdrawal of gas from storage facilities. Because the need for NTS entry capacity to withdraw gas is typically seasonal we conclude that not to make unsold capacity available would inevitably be detrimental to security of supply if shippers cannot get access to unsold capacity in the shorter-term.*"

4. The implications for Transporters and each Transporter of implementing the Modification Proposal , including

a) implications for operation of the System:

The Proposer did not "believe this Proposal, if implemented, would adversely affect the operation of the System."

Other comments were expressed as shown in the quotations within this and other sections of the report.

STUK stated that "*..While the regime cannot be expected to remain static STUK believe that this proposal will undermine the auction process and fundamentally change the nature of the base line product made available by Transco. It has always been clear that the baseline levels of capacity should be made available and that Transco should manage delivering against this capacity through the buyback market. If Transco needs to invest to meet this capacity level it has a choice to invest or buy back the capacity either on the day or through forwards and options contracts. Therefore Transco already has a number of mechanisms in place to manage its exposure to baseline capacity provision. This modification seeks to shift the balance of risk between Transco and shipper without suitable justification.*

The addition the two elements for avoiding the release of unsold capacity will undermine the capacity product as it bases the availability of the remaining unsold capacity on an assessment by Transco that it cannot physically deliver such capacity. As with 0037, there is no clarity as to what such an assessment would be or any criteria to objectively test if this is the case. The suggestion that written permission would be sought from the authority to not release unsold capacity offers little comfort despite assurance ... that permission would only be given in specific circumstances. It fails to recognize that this fundamentally changes the basis of the products being sold.

This modification will not better facilitate the economic and efficient operation of the NTS pipeline system as it could lead to increases in the cost of short term capacity auctions or on the secondary market as Transco limit the level of capacity available to the market

(potentially creating the prospect of over recoveries as seen when Transco limited the level of capacity available based on demand levels). Such increases would inevitably be passed on to consumers.”

The SME notes that the Proposal aims to address situations where Transco NTS has no choice whether to invest or buy-back capacity due to the circumstances identified in the proposal. In the event that Transco NTS would find itself unable to complete the required investments on time, then it believes that it would have no choice but to buy-back the capacity.

b) development and capital cost and operating cost implications:

The Proposer considered that this Proposal "would reduce the potential increase in buy backs costs it may incur above that which would be considered to be economic and efficient. However, if Transco NTS did not release unsold capacity, it may limit its opportunity to earn entry capacity investment incentive revenue under Special Condition C8B Part 2 paragraph 14(5) of its Transporters Licence."

Other comments were expressed as shown in the quotations within other sections of this report.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

The Proposer did not "believe this Proposal, if implemented, requires it to recover any additional costs."

Other comments were expressed as shown in the quotations within other sections of this report.

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

The Proposer commented that in the event that implementation of this Proposal affected a restriction in "the release of incremental obligated entry capacity, the associated revenues would be treated under the SO Entry Capacity Investment Incentive arrangements." However, the Proposer also commented that if implementation of this Proposal led to a restriction in "the release of NTS SO baseline capacity (as defined in Transco NTS's GT Licence), there could be a modest increase in the TO commodity charge."

Other comments were expressed as shown in the quotations within this and other sections of this report.

SSE stated that "Transco NTS has provided no information about the impact that this proposal would have on its ability to recover TO Allowed Revenue in respect of unsold capacity that comes within the baseline. Our interpretation of the UNC definition of Unsold NTS Entry Capacity is that it includes all categories of firm entry capacity, from QSEC to DSEC. This means that if this proposal were implemented Transco would be entitled to withhold for sale the 20% of baseline capacity held back from the long-term auctions for sale in the AMSEC auctions plus any unsold baseline from the QSEC auctions. What impact might this have on the TO revenue recovery position? We therefore disagree with Transco's assertion that this proposal does not impact on price regulation."

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The Proposer believed "that this Proposal could reduce the contractual risk that it is exposed to by reducing the volume of capacity that it is required to offer for sale in specific circumstances. However the proportion of buy-back costs which Transco NTS would incur over the periods considered by this Proposal (ie. from Apr 2007) are still to be determined – this will be considered in establishing future Transmission Price Controls."

Other comments were expressed as shown in the quotations within other sections of the report.

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

The Proposer did not envisage any impact on the UK Link System if this Proposal were to be implemented.

No other views were expressed.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The Proposer considered that implementation of this Proposal "would reduce the potential increase in buy backs costs incurred by itself and Users above that which would be considered to be economic and efficient. The proportion of the total buy back costs incurred by Transco NTS and Users would of course be considered as part of future Transmission Price Controls."

However, the Proposer also considered that this was "a separate issue as to whether it is appropriate to release capacity in the knowledge that it is likely to give rise to buy-back costs, which must ultimately impact end consumer costs."

Other comments were expressed as shown in the quotations within this and other sections of this report.

Risks and rewards under Transmission Incentive Mechanisms

E.ON UK stated "Ofgem state in their initial consultation on Transmission price control review, the importance of ensuring 'licensees bear an appropriate share of the risk of underperformance under the price controls in relation to, for example, the cost of buying back capacity rights if investment by a licensee is not focused and timely'. It is our opinion that this modification proposal continues to weaken such fundamental incentives. Ofgem appear to substantiate this point in their price control review, stating that "Ofgem will seek to use rolling 5-year retention periods for efficiency savings in both operating and capital expenditures as a means of ensuring consistent strength of incentive.

We continue to maintain that incentives and revenues are set relating to the required baseline and incremental outputs and any proposal which impacts these must be dealt with through the proper mechanisms of a price control review and not through a Code

modification, to ensure the full impact of the proposals is understood and appropriately assessed."

SSE stated *"Our understanding of the TO and SO incentive regime framework for the NTS entry capacity regime is as follows:*

- *Transco must release for sale a volume of baseline capacity, for which it receives TO allowed revenue. However, under this urgent modification proposal Transco would not even be required to release unsold baseline capacity. In our view therefore, if this proposal were to be implemented Transco would be in breach of its licence obligations; and*
- *In response to the signals received via the auctions, coupled with other planning information, Transco will determine whether or not to release additional, incremental "obligated" capacity for which it receives SO incentive revenue. The decision as to whether or not to release obligated will be influenced by Transco NTS's assessment of the reward of releasing the incremental capacity vs the buy back risk. It should be noted that the entry capacity product sold in the auctions is a financially firm product. It is up to Transco NTS to determine whether or not to invest in a physical asset to underpin that financially firm right. We therefore disagree with Transco's reasoning that its obligation to release unsold entry capacity should be curtailed in circumstances where it considers there to be a significant risk that the capacity offered for sale cannot be physically delivered.*

We believe such an approach would significantly undermine the existing basis on which capacity is made available, offered and delivered as well as the incentives regime."

In respect of the quotation in the first bullet point above, the SME notes that Special Condition C8B Part 2 paragraph 14(5)(f)(ii)(a) of the Transco NTS Transporters Licence obliges Transco NTS to "use all reasonable endeavours to offer for sale" all obligated entry capacity. If this Proposal is to be implemented, Transco NTS would appear to be required to meet the licence obligation prior to making any decision whether or not to release unsold capacity. The Proposal, if implemented, would therefore appear to be compatible with the Transco NTS licence obligations.

BGT stated *"..we have some sympathy with the view that the Transporter should not be obliged to provide capacity above the baseline level where this has not been already allocated within an auction or allocation process in accordance with the Incremental Entry Capacity Release (IECR) statement. An example of this may be where winter quarters have been bid for and allocated in the QSEC process but for some reason it is not possible to provide the same level of incremental capacity in summer quarters.*

However, the proposal also seeks to relieve the Transporter of the obligation to make available System Entry Capacity (SEC) up to the level of SO Baseline. British Gas Trading (BGT) believe that this is totally unacceptable. To allow quantities of SEC below baseline to be withheld undermines the basis of the Price Control and the incentives regime which they are subject to..."

BGT also stated *"We recognise that this obligation does not extend to the gas day itself in order to reflect the physical limitations upon capacity due to the configuration of the system and the pattern of gas flows on that day.*

Our understanding is that Baseline Capacities have been assessed as the current capability of the gas transmission system as it already exists. This is also the basis of the assets held by the NTS Transporter upon which they are allowed a rate of return reflected in their Price Control formula. To allow the NTS Transporter to withhold any element of this baseline capacity suggests that there are amounts within their allowed revenue related to assets that do not exist. As has been suggested in our previous response, if this is the case we believe that the Transporter should be exposed to a greater proportion of the buyback cost within their incentive arrangements.

We do not accept that the baseline quantities of capacity can be restricted in any way without a commensurate review of their Price Control and Incentive regime."

SGD noted that the "urgent modification proposal ... proposes that Transco NTS's current obligations to offer unsold capacity be limited when certain criteria are met, namely that there is a risk that Transco will be unable to deliver the capacity or that there will be high buy back costs...."

SGD considered "this proposal to contain major changes in approach from that originally implemented for the LTSEC auctions and the incentives on Transco. Transco has been given a number of complex incentives in its price control to encourage it to maximise available capacity and to take on risk when it cannot deliver capacity sold. Transco accepted these incentives but now appears to be responding to them not by making investment or finding other commercial solutions but by changing the arrangements themselves. This is inconsistent with the "commercial" approach envisaged for Transco to take."

SGD also noted that "when the LT auctions were put in place, Ofgem stated that it expected shippers' exposure to buy back costs to reduce over time. If Transco's concern is shippers' exposures, it would seem sensible to change the sharing factors to reduce these. However, it appears to us that it is more likely that Transco's concern is its own exposure and the effect that this could have on its incentive package. It may be that Transco has not invested to the extent that it should have to avoid the risk of buy back costs"

Total understood "Transco NTS's concern with regard to being required to sell additional capacity when it believes there is a significant risk that it will not be able to physically deliver all or part of the unsold capacity from the capacity allocation date. However, for auctions that have not yet been held, we see this risk being addressed by modification proposal 0036 to which we have given our qualified support."

The SME notes that Modification Proposal 0036 would only allow Transco NTS to not release incremental capacity under certain criteria. This Modification Proposal 0037 seeks to avoid release of "unsold capacity", which is not covered by Modification Proposal 0036.

SSE noted "if Transco NTS's reasonable assessment is that the risk of buy back costs increasing is so high it should surely seek to renegotiate the buy back element of its incentive scheme with Ofgem."

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

Comments were expressed as shown in the quotations within other sections of this report.

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

Comments were expressed as shown in the quotations within this and other sections of this report.

SSE queried *"the impact this proposal would have on shippers' abilities to meet customer demand and their bidding strategies. Some shippers may have decided not to purchase capacity in the long-term auctions in the knowledge that a certain volume of baseline would be released via the AMSEC auctions. Shippers intending to fine-tune their positions would have that option withdrawn from them. This is completely at odds with our understanding of the licence obligations placed on Transco which were designed to ensure that all unsold capacity was made available to market, particularly capacity that is accounted for under the TO revenue stream."*

BGT stated that the NTS Transporters licence *"... obliges [Transco NTS] to make available 100% of baseline in the AMSEC, RMSEC and daily auctions up until D-1. Capacity below baseline is obligated and there must be no restriction of its availability, as to do so would radically alter the incentive structure built around capacity release."*

In respect of the above quotations, the SME notes that Special Condition C8B Part 2 paragraph 14(5)(f)(ii)(a) of the Transco NTS Transporters Licence obliges Transco NTS to "use all reasonable endeavours to offer for sale" all obligated entry capacity. Transco NTS would not appear to have to release unsold capacity if it can demonstrate that it has met this obligation.

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

Advantages

The Proposer believed that "this Proposal, if implemented, would

- avoid potentially increasing buy-back costs that are already expected to arise as a result of previously allocated capacity at an ASEP above that which would be considered to be efficient and economic and thereby reduce costs for end consumers;
- remove the potential for Users to seek to obtain unsold capacity solely on the expectation that it will receive buy-back payments; and
- limit the applicability of the Proposal to QSEC auctions undertaken during the current formula period. This would allow further consideration as to the amounts of capacity that it is efficient and economic for Transco NTS to release as part of the next Transmission Price Control."

Disadvantages

The Proposer recognised that this Proposal may "limit the amount of unsold capacity that is made available to Users." However, it believed "that this is necessary in the specific circumstances set out in this Proposal."

The Proposer recognised "that this Proposal relies upon Transco NTS assessment of the likelihood of capacity not being physically delivered on time and the potential for buy-back of previously allocated capacity for the affected ASEP. It is also difficult to specify an exact level of risk applicable to all ASEPs and circumstances under which unsold capacity would not be made available. However, in the event that Transco NTS does not make unsold capacity available, were this Proposal to be implemented:

- Transco NTS would still require to ensure it was able to meet Special Condition C8B Part 2 paragraph 14(5)(f)(ii)(a) of its Transporters Licence to "use all reasonable endeavours to offer for sale" all obligated entry capacity and would be expected to require written permission from the Authority to not release unsold capacity; and
- Transco NTS would limit its opportunity to earn entry capacity investment incentive revenue under Special Condition C8B Part 2 paragraph 14(5) of its Transporters Licence, unless the incentive cap had already been met for the relevant year."

Other comments were expressed as shown in the quotations within other sections of this report.

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

Responses were received from:

E.ON UK Plc	(E.ON UK)	Not in Support
Scottish and Southern Energy plc	(SSE)	Not in Support
British Gas Trading Ltd	(BGT)	Not in Support
Statoil (UK) Ltd	(STUK)	Not in Support
Shell Gas Direct Ltd	(SGD)	Not in Support
Total Gas & Power Ltd/Total E&P UK plc	(Total)	Not in Support
ENI UK Ltd	(ENI)	Not in Support
Transco plc Transmission	(Transco NTS)	In Support

Comments were expressed as shown in the quotations within this and other sections of the report.

Timing/urgency

SSE challenged *"the justification made for urgency"* and is surprised that *"... it has been afforded urgent status, with less than two and a half days for respondents to comment on the issues. The timescale is particularly worrying given the significant issues that this proposal raises, such as security of supply, the commercial impact on shippers and the ability of shippers to land gas to meet the needs of their customers."*

BGT stated that *"We would again register our concerns about the extremely short timescale available to Users to consider and respond to this proposal and we re-iterate our*

previous comments contained in our response to Modification Proposals 0036 & 0037 in that matters of this nature are not best served by this hurried and piecemeal approach.

Similarly, we do not believe that there is justification in aligning the Uniform Network Code to the recently amended Incremental Entry Capacity Release statement as we do not believe that Users responses to the consultation on that document have been fully addressed.”

SGD stated “Our concerns expressed in our response to UNC0037 remain regarding the attempt to alter arrangements so close to what is expected to be the start of the next round of LT auctions. This is particularly concerning given the doubts we now have about the timing of the next auction.”

Use of the UNC mod process for this proposal

SSE stated “With regard to the ability of Transco NTS to physically deliver the unsold obligated capacity offered as QSEC within the three year timescale again we would note that this changes the whole basis of the incentive framework that was agreed at the time of the last price control review. We therefore query whether it is appropriate for this change to be pursued under the UNC governance arrangements.”

SSE also stated “..if the level of buy back costs to be incurred as a result of releasing unsold entry capacity is inefficient this suggests that either the baseline levels were set too high, or that Transco’s decision to release incremental obligated capacity has not been efficient. If the volumes that have been allocated as obligated are inappropriate this suggests a need to revise the IECR and not the UNC.”

Total stated “Where capacity has been sold in previous auctions, then this has been offered on the network code terms applicable at the time of that auction and parties bidding for capacity have made firm financial commitments on the basis that the capacity would be available or would be bought back, if unavailable. Any such decisions have also been made on the understanding that, at all times, capacity up to baseline would be offered in one or more auctions and that where obligated entry capacity was released (either as annual or permanent) then any unsold capacity would also be offered for the appropriate periods in future auctions. It is therefore unacceptable for changes to be introduced that would retrospectively affect the value of such capacity. In fact, we believe it is a licence obligation that such capacity should be offered in one or more auctions and we therefore do not understand how the UNC can be changed unless the licence is also changed.”

SSE stated “In our opinion this proposal represents an abuse of the governance process and we do not understand why Transco NTS has left it so late to bring this proposal forward.”

SSE believed that "the issues of concern to Transco NTS are not matters to be resolved via a UNC modification proposal. Rather, we are firmly of the view that this proposal is at odds with our understanding of Transco NTS’s licence obligations to release unsold entry capacity and that any issues that Transco NTS has with these obligations should be addressed via licence modification/price control negotiations with Ofgem. It is not appropriate to use the UNC as a means of “getting round” the licence obligations.

Given this statement we do not understand why Transco is seeking to address its concerns with licence obligations via a UNC modification proposal. Indeed, in doing so, Transco

NTS would appear to be avoiding due process. Furthermore that it would appear reasonable to assume that unless it is more efficient or economic to buy back Transco would physically provide the capacity.”

The SME notes that Transco NTS presented a package of changes to the UNC at the Transmission Workstream meeting on 6th July 2005 following the receipt of Shipper views on the initial IECR proposals. Transco NTS believes that it sought to take account of the comments and suggestions raised at this meeting.

Quantification/cost benefit

SSE commented that “..Transco states that without these provisions in place there could be an adverse commercial impact on Transco NTS and Users as a result of potentially high buy back costs at Aggregate System Entry Points (ASEPs) We note that Transco NTS has made no attempt to quantify the extent of the commercial impact, nor has it indicated the volumes of capacity that could be involved.”

ENI stated that “the current modification is unacceptable because it does not provide a detailed cost-benefit analysis for its implementation and because the criteria for withholding any unsold capacity has not been fully defined.”

SSE noted that “Transco has not provided any evidence to support its concerns that the cost of buy back is going to be so high therefore it is impossible for us to quantify the consequential risks that shippers would face.”

ENI felt that “Transco NTS should provide detailed reasoning with a full cost benefit analysis why they believe Users may face “potentially high buy-back costs”

Criteria for not offering unsold capacity for sale

SSE stated “In proposed 2.1.5 (c) (iii) (i) it all seems to be down to Transco discretion. How is such discretion to be audited. Who will decide whether Transco’s assessment is reasonable? What information will be provided to shippers?

The references to consents, lead times and construction challenges are irrelevant and misleading.”

SGD stated “The proposal to only allow this arrangement to be put in place with written consent from the Authority does not provide the level of comfort we would want. We would welcome details of how this process would work: we recommend that if adopted Transco would publicly state that it was doing this before any agreement between Ofgem and Transco was announced. Any agreement in writing would need to be signed by a member of the Authority itself.”

ENI stated “..(0043) partly addresses the issue of relying solely on Transco NTS’s discretion to withhold unsold capacity by the additional step of requesting permission from the Authority. However, no detail has been provided of how this request process will be carried out, e.g., timescale for responses. Furthermore, the issue of whether a request for permission to withhold unsold capacity is an obligation upon Transco NTS or optional, is unclear.”

Transco NTS stated that it had “..proposed Modification 0043 as a replacement for Modification 0037, which Transco NTS withdrew after careful consideration of the

representations received through the consultation process on the Proposal. This was in respect of User concerns regarding the amount of flexibility that the Modification, if implemented, would grant Transco NTS. Transco NTS considered that it could limit its discretion in the release of unsold capacity to address User concerns through a revision to the original proposal.

Transco NTS thus proposed Modification 0043 limiting the applicability of the initial Modification 0037 to only certain calendar quarters for which capacity would otherwise be released through capacity auctions conducted during Transco NTS's current price control ie. prior to 31 March 2007. In addition, Transco NTS envisages that it would only be able to not release unsold capacity in accordance with the criteria proposed in the Modification with the prior written approval of the Authority. Transco NTS therefore considers that this would provide the required comfort to Users in respect of Transco NTS's utilization of the Modification, were it to be implemented.

The period for which capacity would be released through capacity auctions conducted prior to 31 March 2007 would be beyond the end of Transco NTS's current price control for which incentive arrangements are still to be developed. It is Transco NTS's view that Modification 0043 therefore prevents releasing unsold capacity in defined exceptional circumstances to avoid exacerbating an existing buy-back requirement at an ASEP to prevent cost increases for end consumers until the future entry capacity regime has been further considered and agreed during the next Transmission Price Control Review."

Competition law aspects

SSE stated "It is not for the UNC to remove the potential for shippers to obtain unsold capacity solely on the expectation that they will receive buy back payments. If Transco considers that a party is abusing its position, there are licence and Competition Act provisions to guard against this."

12. The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

No such requirements have been identified.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

No such requirements have been identified.

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

No such requirements have been identified.

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

The Proposer has suggested that this Modification Proposal should be implemented on 18 August 2005.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

No such implications have been identified.

17. Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 17th August 2005, of the nine Voting Members participating, one voted in favour of recommending implementation of this Modification Proposal. Therefore no recommendation was made.

18. Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

UNIFORM NETWORK CODE - TRANSITION DOCUMENT

PART IIC – TRANSITIONAL RULES

Insert the following as new paragraph 1.1, and renumber existing paragraphs accordingly:

1.1 TPD Section B: System Use and Capacity

1.1.1 TPD Section B2.1.5 and Section B2.1.6

- (a) In respect of any invitations for Quarterly NTS Entry Capacity issued prior to 31 March 2007, then the Unsold NTS Entry Capacity which Transco NTS shall be required to offer in such invitation shall be determined as follows:

In respect of an Aggregate System Entry Point and in relation to a Day in a calendar month in a Formula Year, "Unsold NTS Entry Capacity" is the amount of Firm NTS Entry Capacity that Transco NTS has, in relation to each Day in a calendar quarter, an obligation to make available (in accordance with the procedures set out in UNC TPD Section B2) to Users pursuant to paragraph 14(5)(f) of Part 2 of Special Condition C8B of Transco NTS's Transporter's Licence as, in the case of Quarterly NTS Entry Capacity to be made available under UNC TPD Section B2.2, set out in Transco NTS's Transportation Statement; provided that where the Authority has so consented in writing:

- (i) such Unsold NTS Entry Capacity shall not include any NTS Entry Capacity which Transco NTS assesses it may be unable to physically deliver for any reason if such NTS Entry Capacity were to be allocated at a given Aggregate System Entry Point, including for example, due to the length of time required to obtain consents or construction challenges; and
- (ii) such Unsold NTS Entry Capacity for a particular Aggregate System Entry Point shall be zero where Transco NTS assesses there is an expectation that Transco NTS would be required to accept daily capacity offers pursuant to UNC TPD Section B2.10 in respect of previously allocated NTS Entry Capacity at that Aggregate System Entry Point;

and (for the avoidance of doubt) the provisions of UNC TPD Section B2.1.5 shall not apply for the purposes of UNC TPD Section B2.2 in relation to any invitations for Quarterly NTS Entry Capacity issued prior to 31 March 2007.

- (b) In respect of any allocations of Quarterly NTS Entry Capacity pursuant to an invitation issued prior to 31 March 2007, then, for the purposes of the application of UNC TPD Section B2.6, the amount of Unsold NTS 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 NTS Entry Capacity through the application of paragraph 14(5) of Part 2 of Special Condition C8B of Transco NTS's Transporter's

Licence prior to the time at which the amount of Unsold NTS Entry Capacity is to be ascertained; provided that where the Authority has so consented in writing:

- (i) the amount of Unsold NTS Entry Capacity in existence at a particular time shall not include any NTS Entry Capacity which Transco NTS assesses it may be unable to physically deliver for any reason if such NTS Entry Capacity were to be allocated at a given Aggregate System Entry Point, including for example, due to the length of time required to obtain consents or construction challenges; and
- (ii) the amount of Unsold NTS Entry Capacity in existence at a particular time for a particular Aggregate System Entry Point shall be zero where Transco NTS assesses there is an expectation that Transco NTS would be required to accept daily capacity offers pursuant to UNC TPD Section B2.10 in respect of previously allocated NTS Entry Capacity at that Aggregate System Entry Point;

and (for the avoidance of doubt) the provisions of UNC TPD Section B2.1.6 shall not apply in such circumstances.

- (c) Where (by virtue of the provisions of paragraph 1.1.1(a) or 1.1.1(b) above) the Unsold NTS Entry Capacity for a particular Aggregate System Entry Point is zero for a particular calendar quarter, then the Unsold NTS Entry Capacity for the purposes of paragraphs 2.2 (in relation to Monthly NTS Entry Capacity only), 2.3 or 2.4 of UNC TPD Section B shall also be deemed to be zero for each calendar month or Day within such calendar quarter, and (for the avoidance of doubt) the provisions of UNC TPD Section B2.1.5 shall not apply for the purposes of UNC TPD Section B2.2 (in relation to Monthly NTS Entry Capacity only), 2.3 or 2.4 in such circumstances.

Subject Matter Expert sign off:

I confirm that I have prepared this modification report in accordance with the Modification Rules.

Signature:

Date :

Signed for and on behalf of Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters

Signature:

Date :