

Modification Report
Transitional Arrangements for Entry Capacity Transfers to Sold Out ASEPs
Modification Reference Number 0138
Version 2.0

This Modification Report is made pursuant to Rule 10.1 of the Modification Rules and follows the format required under Rule 10.2.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 10.1.2, Ofgem agreed that this Modification Proposal should be treated as Urgent because:

- 1) *“There is a real likelihood of significant commercial impact upon Gas Transporters, Shippers or Customers if a proposed modification is not urgent;*

Assuming that this proposal addresses the issue it purports to address and were subsequently to be approved, then it is likely that it not being implemented on the urgent timetable will potentially lead to a significant commercial impact on gas shippers and suppliers (who might wish to bid in the May AMSEC auctions, an imminent date related event as discussed below). In addition if, as suggested by the proposer, sterilised capacity is a problem there could be an impact on consumers if gas prices are higher than they otherwise would be.

- 3) *The proposal is linked to an imminent date related event*

The proposer suggests that the imminent date related event is the AMSEC auction as shippers and other commercial parties would need to know whether or not this proposal has been implemented in order to decide how to act in the capacity auctions. Subsequent to Ofgem receiving this proposal National Grid announced that the first round of AMSEC auctions will take place on 11 May 2007.

Given the potential commercial impact identified above Ofgem agrees that in these circumstances the AMSEC auction is an imminent date related event for the purposes of this criterion.”

Procedures Followed:

The procedures agreed with Ofgem for this Proposal were:

Process	Date
Proposal issued for consultation	02/04/2007
Close out of representations	12/04/2007
Urgent modification report issues	16/04/2007
Modification Panel decide on upon recommendation	24/04/2007
Revised urgent Modification Report sent to Ofgem	26/04/2007
Ofgem Decision Expected	08/05/2007
Proposed implementation date	09/05/2007

1 The Modification Proposal

Under the current price control (2002-2007), National Grid NTS is obliged under its Gas Transporter Licence to use all reasonable endeavours to offer for sale a baseline level of capacity at each Aggregate System Entry Point (ASEP), in at least one

clearing allocation. This provides certainty to Users of the available capacity amounts, but does not allow the flexibility for either:

- sold capacity held by a User at one ASEP to be transferred to another ASEP where the User (or another User) has a greater need for such capacity; or
- unsold capacity (i.e. amounts of obligated baseline capacity that have not been sold) to be reallocated to where Users value it most once the baselines have been set at the start of a price control.

Ofgem have therefore proposed as part of their Final Proposals for the Transmission Price Control Review (TPCR) that an obligation is placed on National Grid NTS to facilitate the transfer of both sold and unsold capacity between ASEPs. National Grid NTS has accepted, in principle, Ofgem's Final Proposals.

In anticipation of the licence change, National Grid NTS proposed that an amendment is introduced within the UNC which would allow the transfer of unsold capacity between ASEPs through an Annual Monthly Transfer Auction (AMTSEC) (Modification Proposal 0133). This, however, only addresses the Licence obligation to transfer unsold capacity, not the Licence obligation to also facilitate the transfer of sold capacity. For clarity, this Proposal should not affect development of any Modification Proposals on unsold capacity and we are satisfied currently that National Grid is able to deliver a 2007 AMTSEC auction in normal regulatory timescales and thereby meet the needs of market participants.

The Proposer recognises that the process of transferring sold capacity could, in the extreme, be complicated (eg transferring capacity in operational timescales) and that National Grid have initiated development of a proposed "enduring solution", which was presented at the Transmission Workstream on 01/02/2007. At the same meeting, E.ON UK put forward draft proposals for a sold capacity transfer process (SCTP), with the intention that this would be a transitional arrangement to be implemented well before winter 2007. The feedback subsequently received from National Grid has indicated that E.ON UK's proposal would not achieve a sold capacity transfer process before National Grid's proposed solution – i.e. no earlier than October/November 2007.

The Proposer does not find the proposed implementation date of October/November 2007 acceptable. Although we understand that National Grid have investigated what can be achieved in normal regulatory timescales this year, the Proposer does not consider National Grid can implement a sold capacity transfer mechanism when it is needed most by market participants –i.e. after the 2007 AMSEC auction.

The Proposer has met with National Grid on several occasions to express our concerns and encourage a more rapid implementation; most recently further to an action taken away to meet with NG from the February Transmission Workstream. Unfortunately, National Grid has been unable to provide assurance to date that as soon as the new TPCR baselines are implemented, that a transfer mechanism for sold, and then unsold, capacity will be made available to Users. The Proposer considers it imperative that a sold capacity transfer mechanism is available to Users following the AMSEC and before the AMTSEC auction in 2007 (and on an annual basis thereafter,

until an enduring solution is implemented in the UNC).

E.ON UK therefore proposes a simple, straightforward transitional mechanism which could be implemented quickly to allow only the transfer of sold capacity to ASEPs that have sold out. To achieve this by the stated implementation date of 01/05/2007, Urgent status is required.

The main advantages of transferring sold capacity ahead of unsold capacity are:

- Allows Users to optimise their own portfolio before entering the market for unsold capacity;
- The Sold Capacity Transfer Process will allow the transfer of capacity from any other ASEP, not just those that have unsold baseline, and thus the AMTSEC, if initiated before the Sold Capacity Transfer Process, may miss the most efficient ASEP (i.e. with highest transfer rate);
- Avoids reducing the available unsold capacity at the Donor ASEPs available for purchase in the within-year auctions – the AMTSEC will likely just result in further ASEPs becoming sold out.

Overall this will ensure a more efficient allocation of capacity by allowing more scope for market participants to determine at which ASEPs they most want to hold capacity.

As a result, for 2007 and until an “enduring” solution is implemented in the UNC, it is proposed that the following transitional arrangements are implemented:

Transfer Initiation Process

1. In the event that any ASEP sells out for any month as part of the Annual Monthly System Entry Capacity (AMSEC) auction in Capacity Year Y (i.e. in the following two Capacity Years (Apr Y+1 to Mar Y+2), National Grid NTS shall:
 - a. Firstly, invite applications from Users to transfer capacity they hold at other ASEPs to the sold out ASEPs.
 - b. Secondly, hold another pay as bid auction (the Annual Monthly Transfer System Entry Capacity “AMTSEC” auction) to facilitate the transfer of unsold entry capacity as soon as possible after the SCTP has concluded. The AMTSEC is the subject of a separate UNC Modification Proposal, 0133, and is therefore not described in any more detail here.
2. In the event that an enduring solution is not implemented before the start of the calendar year 2008, it is proposed that the AMSEC auction is held in January 2008, as opposed to February, to allow additional time for the Sold Capacity Transfer Process and AMTSEC auctions ahead of the following Capacity Year.

Sold Capacity Transfer Process:

3. For each month where one or more ASEP is sold out (“Available Month”), each ASEP is classified as one of the following:
 - a. Recipient ASEP – no unsold capacity available; i.e. all capacity made

available in the AMSEC auction has been sold (“sold out”)

- b. Donor ASEP – another ASEP from which sold capacity could be transferred.
4. National Grid NTS will within 2 business days of publication of the results of the AMSEC auction, invite Users to register to be able to participate in the Sold Capacity Transfer Process.
5. If a User desires to participate in the Sold Capacity Transfer Process they must within 2 business days of the invitation to register:
 - a. commit to pay the application fee to National Grid NTS (as stated in National Grid NTS’ Transportation Charging Statement to cover costs of determining Transfer Rates and undertaking the transfer process, and hence will not be refundable)¹; and
 - b. State the Recipient ASEP(s) and the months, which must be Available Months, in respect of which the User desires to transfer capacity.
6. For those Users that have successfully registered to participate in the Sold Capacity Transfer Process (“SCTP Users”), National Grid NTS will publish within a further 14 days and with at least 7 days notice prior to the transfer window, an invitation containing:
 - a. the date on which applications to transfer shall be made (the “transfer window”);
 - b. for each Recipient ASEP and each Available Month
 - i. the Transfer Rate for each Donor ASEP (where a “Transfer Rate” between a Recipient and Donor ASEP of e.g. 10:1 or 0.1 means that 10 units at the Donor ASEP is equivalent to 1 unit at the Recipient ASEP);
 - ii. the maximum amount of Monthly NTS Entry Capacity that can be accommodated at that Recipient ASEP (the “Nodal Maximum”);
7. National Grid NTS will determine the Transfer Rates and Nodal Maxima in accordance with the Entry Capacity Transfer Methodology Statement. National Grid NTS is obligated to produce this statement under its GT Licence as a result of acceptance of Ofgem’s Final Proposals for the TPCR.
8. SCTP Users may apply for Monthly NTS Entry Capacity at a Recipient ASEP for any Available Month, which may be met by the transfer of capacity held by such SCTP User from one or more Donor ASEPs in accordance with the allocation methodology described below.
9. An application in respect of an Available Month must state:
 - a. the identity of the User (must have participated in the Transfer Initiation Process);

¹ We would envisage that the application fee would be fixed prior to the invitation to participate in the Sold Capacity Transfer Process.

- b. the Recipient ASEP;
 - c. the Donor ASEP
 - d. the Available Month;
 - e. the amount (not less than the minimum eligible amount) of Monthly NTS Entry Capacity applied for at the Recipient ASEP (in kWh/Day); and
 - f. the minimum amount (not less than the minimum eligible amount) of Monthly NTS Entry Capacity which the User is willing to be allocated.
10. It is important to note that this is a transitional process for Users to transfer capacity holdings between ASEPs within one User account. The mechanism to transfer capacity between different User accounts at an individual ASEP already exists. For simplicity, it is important to keep these two processes separate as a Sold Capacity Transfer Process that simultaneously combines the two would necessarily be more complex and costly for National Grid NTS to administer, which would necessarily be reflected in the application fee. Also, the changes required to Gemini are understood to be minimal if the two processes are separated.
11. A User may have, at any one time, only one application in respect of each Donor-Recipient ASEP combination for each Available Month.
12. A User may submit applications, and thereafter withdraw or amend as required during the period 08:00 hours to 17:00 hours on the day of the transfer window.
13. National Grid NTS will reject a bid (and it will therefore not be part of the allocation process described below) where:
- a. any of the above requirements are not met;
 - b. the User does not have sufficient capacity at the Donor ASEP to meet capacity requested at the Recipient ASEP, based on the Transfer Rate.
14. User's applications will be allocated as follows:
- a. Where the aggregate of the capacity requested in respect of a Recipient ASEP is less than or equal to the Nodal Maximum at that Recipient ASEP, the transfers requested by all Users will be met in full;
 - b. Where the aggregate of the capacity applied for in respect of a Recipient ASEP is greater than the Nodal Maximum at that Recipient ASEP, the transfers requested by all Users will be reduced pro rata based on the capacity applied for at the Recipient ASEP such that the total transferred to the Recipient ASEP is equal to the Nodal Maximum.
 - c. Where the amount to be allocated in respect of a bid pursuant to the above is less than the minimum amount specified in the capacity application, the application will be disregarded and a revised allocation will be made between remaining applications.
15. National Grid NTS will provide to Users their allocations within 2 Business Days after the day applications were made and within a further 1 Business Day the

following information to all Users:

- a. in respect of each Recipient ASEP for each Available Month, the aggregate amount of Monthly NTS Entry Capacity allocated;
- b. in respect of each Donor ASEP for each Available Month, the amount by which the NTS Entry Capacity was reduced.

Interaction with AMTSEC Auction

16. For clarity this Modification Proposal should not affect on-going development or eventual operation of a proposed unsold capacity transfer mechanism. However, it is imperative that the Sold Capacity Transfer Process should only occur after the AMSEC auction has concluded and before any AMTSEC auction begins.

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

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;

Some respondents believed that implementation would provide Users at sold out ASEPs the opportunity to seek to transfer sold capacity from other ASEPs. This would result in the avoidance of sterilisation of capacity and stranding of gas offshore, and thereby better facilitate the achievement of this objective.

However, others believed that this objective would only be facilitated if the transfer of unsold capacity were to precede trading of sold capacity. If this order of transaction did not apply there would be some incentives on Users to purchase capacity in order to prevent the transfer of unsold capacity. NGD also questioned whether implementation would alleviate capacity sterilisation.

NGNTS pointed out that to implement the Proposal all potential permutations of trades and capacity amounts would have to be taken into account. This would result in very low exchange rates and inefficient re-allocation of capacity. It argued from this that implementation would not better facilitate the achievement of this objective.

Some respondents made the general point that if UNC Proposals were implemented with haste the effect could be counter-productive. Where a Proposal is made in response to a new licence condition details of the licence changes, any associated Methodology Statements and other related documents should be made available so that respondents can evaluate the consequences of implementation.

Standard Special Condition A11.1 (c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

Implementation would meet new Licence obligations on National Grid NTS to facilitate the transfer of sold capacity between ASEPs.

Some respondents were concerned that implementation could encourage Users to purchase capacity in the long term QSEC auctions with the intention of transferring it to another ASEP. This might lead to perverse investment signals for National Grid

NTS.

Standard Special Condition A11.1 (d): *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers...*

Implementation would facilitate achievement of this objective by making more capacity available at ASEPs that have been sold out.

By giving greater scope to market participants to determine at which ASEPs they most value holding capacity, Users would be able to make more efficient choices as to their use of the system and this would in turn help facilitate bringing the most competitively price gas to market.

However, some respondents believed that implementation would favour Users who already hold capacity at numerous ASEPs at the expense of Users who do not hold capacity this would not facilitate achievement of this objective. It was pointed out that, in the event of implementation, Users would not be able to evaluate what capacity would be available at a given ASEP at a given time and this degree of uncertainty would act as a barrier to entry.

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

Implementation would enhance security of supply by allowing Users the opportunity to obtain additional capacity at sold out ASEPs well before the start of winter 2007, which would not otherwise be the case.

However EDFE pointed out that if implementation led to erroneous investment signals this would have an adverse effect on security of supply.

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

a) implications for operation of the System:

By optimising the release of entry capacity, implementation would provide a greater opportunity to ensure gas supplies can be delivered where demand exceeds the baseline capacity of an ASEP.

b) development and capital cost and operating cost implications:

Implementation would have some cost implications related to the delivery of the required transitional system changes, operation of the additional process, calculation of the Nodal Maxima / Transfer Rates and publication of information. Nonetheless, if implementation avoided the potential sterilisation of entry capacity it would prevent costs being incurred inefficiently.

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

Implementation would require National Grid NTS to recover the costs associated with the system development. Operating costs in respect of determination of Transfer Rates and the transitional SCTP are intended to be recovered by application fees to be described in a transportation charging methodology statement.

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

No such consequences have been identified.

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

NGNTS identified that it would be unable to provide the fixed exchange rates proposed as the ratio would not be fixed and dependent on the amount of capacity transferred. It would therefore be unable to implement this aspect of the Proposal.

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

Implementation would have an impact on the UK Link System. These transitional arrangements have been specifically developed, however, to minimise the development costs and maximise the use of existing processes and systems (particularly Gemini).

Several respondents expressed concern at the prospect of datafixes in order to allow early implementation.

NGNTS suggested an alternative approach whereby a National Grid NTS Trading Account would be set-up although manual suppression of some charges might be required.

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

Administrative and operational implications (including impact upon manual processes and procedures)

Users would have greater certainty about the availability of capacity, which would, in turn, better facilitate the optimisation of their portfolio(s) before winter 2007.

Some respondents pointed out that implementation might have a material impact on User's bidding behaviour in the May 2007 AMSEC auction.

Development and capital cost and operating cost implications

No such implications have been identified.

Consequence (if any) on the level of contractual risk of Users under the Uniform Network Code of the Individual Network Codes proposed to be modified by this Modification Proposal

Some respondents believed that implementation would create additional uncertainty about the level of capacity available if it led to Users securing capacity in the QSEC auctions with the intention of transferring it to other ASEPs. Implementation might also lead to distortion of the market ahead of the AMTSEC auction, if such auctions occurred.

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

No such implications have been identified in the responses.

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

No such consequences have been identified.

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

Advantages

- Is a straightforward, transitional arrangement, which builds on existing processes in order to minimise costs to the industry, to address a real, significant problem faced by Users in respect of entry capacity availability pre-winter 2007.
- Would allow flexibility for sold capacity to be reallocated to where Users value it most once the baselines have been set in 2007 (and until an enduring solution is implemented in the UNC).
- Would allow Users the opportunity to secure additional capacity, in excess of an ASEP's baseline, therefore allowing gas flows onto the system that may otherwise be prevented;
- May avoid the potential sterilisation of entry capacity and hence costs being inefficiently incurred;
- By allowing a sold capacity transfer process to take place before an unsold capacity transfer process would enable Users to optimise their own portfolios before entering the market to seek additional capacity. This would enable Users to act more efficiently and removes a limit on market participant's freedom to trade capacity, which would be caused by a purely unsold capacity transfer

mechanism;

- Could be implemented well ahead of next winter.

Disadvantages

- Would introduce a further process into entry capacity arrangements.
- Potentially unworkable as exchange rates are dependent on the amount of capacity transferred but this Proposal requires such exchange rates to be determined in advance of the SCTP.
- Potential for the whole transfer process to be sabotaged.

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

Representations have been received from the following:

British Gas Trading	BGT	Qualified support
EDF Energy	EDFE	Not in support
E.ON UK	EON	Support
National Grid Distribution	NGD	Not in support
National Grid NTS	NGNTS	Not in support
RWE Npower plc and RWE Trading GmbH	RWE	Not in support
Scottish and Southern Energy plc	SSE	Support
Shell Gas Direct Ltd	SGD	Support
Statoil UK	STUK	Not in support

Thus, of the nine responses received, three supported implementation, one offered qualified support and five did not support implementation.

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

No such requirement has 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 requirement has been identified.

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

The Transporter would be required to put in place the necessary processes and supporting systems to allow the capacity transfers to take place. This is estimated by NGNTS as six to eight weeks following the definition of firm business requirements.

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

An implementation date of 9 May 2007 has been suggested.

However, NGNTS suggested a minimum of six to eight weeks would be required to implement this Proposal following definition of firm business requirements.

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 24 April 2007, of the seven Voting Members present, capable of casting eight votes, three votes were cast in favour of implementing this Modification Proposal. Therefore the Panel did not recommend implementation of this Proposal.

18 Transporter's Proposal

This Modification Report contains the Transporter's proposal not to modify the Code and the Transporter now seeks agreement from the Gas and Electricity Markets Authority in accordance with this report.

19 Text

No text has been provided.

For and on behalf of Relevant Gas Transporters:

Tim Davis

Chief Executive Joint Office of Gas Transporters