

Modification proposal:	Uniform Network Code (UNC) 230/230AV: Amendment to QSEC and AMSEC Auction timetable		
Decision:	The Authority ¹ directs that UNC230AV should be made and UNC 230 should not be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	29 May 2009	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

The Uniform Network Code (UNC) currently specifies that the annual auctions of quarterly and monthly system entry capacity are held in September and February respectively. In the September QSEC (Quarterly System Entry Capacity) auction the need for additional, or incremental, capacity in the National Transmission System (NTS) can be signalled by Shippers. Providing that the signal meets the economic criteria, NGG (National Grid Gas) as system operator is obliged to provide the incremental entry capacity. This is often but not exclusively met by new build, i.e. the construction of physical capacity.

With the current default lead time, incremental capacity signalled in a September QSEC is usually expected to be released in April, 42 months later. If this is met through a new build, then the final period of construction is over a winter period. This may increase the risk of delay in the delivery of capacity and the cost of construction. Both the original proposal (UNC230) and its variant (UNC 230AV) seek to change the QSEC auction date such that the final construction period would be over the summer.

Ofgem previously rejected a modification (UNC189)³ which sought to align the release of incremental capacity with the start of the gas year by proposing an April QSEC. Our decision on UNC189 indicated that the timing of the QSEC, together with the default lead time for incremental capacity release, should ideally result in a final construction period over the summer. The current proposals would succeed in this aim⁴.

The modification proposals

UNC230: Amendment to QSEC and AMSEC Auction timetable

National Grid Gas (NGG) proposes to move the QSEC to March, move the Annual Monthly System Entry Capacity (AMSEC) auction to June, and change the definition of the capacity year.

The proposer believes that these changes would:

- lead to capacity being released at the start of the winter period, when flows increase;

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ Ofgem decision letter. Amendment to the QSEC Auction timetable (13 March 2008)

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=UNC189%20Rejection%20Letter.pdf>

⁴ The default lead time for incremental capacity release was increased from 36 months to 42 months in the 2007-2012 price control (Transmission Price Control Review 4). This reflected some evidence that the typical time to obtain planning consents had increased since the previous Transmission Price Control Review.

- provide increased timeliness of delivery of Incremental NTS Entry Capacity signalled at the QSEC auction, as NGG would be able to make full use of the final summer build period immediately prior to the capacity delivery date for constructive activities;
- allow signals received through the QSEC auction to feed into both the Transporting Britain's Energy consultation (TBE)⁵ enhancing that process and the proposed enduring exit application/auction processes, allowing more accurate network analysis and planning.

The movement of the AMSEC auction date is to align release periods with the QSEC and to avoid overlapping auction processes. A key feature of the proposal is that there would not be a September 2009 QSEC.

The proposer considers that UNC230 will better facilitate the relevant objectives of Standard Special Condition A11.1 (a), (c), (d) and (f).

Modification proposal UNC230AV

UNC230AV was proposed by E.ON. The proposal is to move the QSEC to March from 01/03/2010 onwards and retain the February AMSEC, but shorten the period for which it offers capacity from 2 years to 18 months. The proposal is designed to address concerns that under UNC230 there would be a gap of 18 months between the 2008 QSEC and the subsequent March 2010 QSEC. A gap of this duration would not have been anticipated in 2008 QSEC bids and this may frustrate the ability of shippers to secure the firm capacity rights they want.

E.ON's proposal also meets a concern that was expressed by some Shippers that the original proposal would result in different reserve prices for capacity at the same point in time. An additional concern was that a June AMSEC (as proposed by UNC230) would create difficulties in shaping capacity holdings to take into account the unavailability of offshore gas delivery facilities due to scheduled maintenance activities.

The proposer considers that UNC230AV will better facilitate the relevant objectives of Standard Special Condition A11.1 (a), (c), and (d).

UNC Panel⁶ recommendation

At the UNC Modification Panel meeting held on 19 February 2009, of the 10 Voting Members present, capable of casting 10 votes, 2 votes were cast in favour of implementing Modification Proposal UNC 230. Therefore the Panel did not recommend the implementation of this Proposal. At the same meeting, 5 votes (drawn from the 10 Voting Members present) were cast in favour of implementing Alternative Proposal UNC230AV. Therefore the Panel did not recommend implementation of Alternative Proposal UNC230AV.

The Panel then proceeded to vote on which of the two Proposals would be expected to better facilitate achievement of the Relevant Objectives. Of the 10 Voting Members present, capable of casting 10 votes, 2 votes were cast in favour of implementing Modification Proposal UNC230 in preference to Alternative Proposal UNC230AV, and 5

⁵ www.nationalgrid.com/uk/Gas/OperationalInfo/TBE/

⁶ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

votes were cast in favour of implementing the Alternative Proposal UNC230AV in preference to Proposal UNC230. Therefore the Panel determined that, of the two Proposals, Proposal UNC230AV would better facilitate the achievement of the Relevant Objectives.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) for UNC230/UNC230AV dated 22 April 2009. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR⁷. The Authority has concluded that:

1. implementation of the UNC230AV will better facilitate the achievement of the relevant objectives of the UNC⁸; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁹.

Reasons for the Authority's decision

Response to consultation

There were 8 responses to the Joint Office consultation on UNC230/230AV. Of these, one response opposed the implementation of either proposal. Two responses indicated support for the implementation of either proposal, with one (NGG) stating a preference for UNC230 and the other for UNC230AV. The remaining 5 responses supported the implementation of UNC230AV but not UNC230. Our interpretation of the responses and the votes at panel is that there was good support for moving the date of the QSEC to March. However, all Shippers who responded opposed the removal of the 2009 QSEC. While UNC230AV succeeded in addressing this concern it also proposes a reduction of the AMSEC transaction period from 2 years to 18 months. The reduction of the AMSEC transaction period was opposed by two respondents.

a) the efficient and economic operation of the pipe-line system

In Ofgem's view, the main benefit of both proposals is that they allow a summer period to complete the construction of any necessary incremental capacity and facilitate its release for the winter period. As outlined above, this should reduce costs and improve the timeliness with which capacity is provided. NGG identified these reasons for considering that both proposals met the efficiency and economic operation objective. Another respondent also suggested that both proposals met this objective.

A contrary position was taken by a single Shipper who expressed the view that there would be no such benefit on the basis that bids for capacity rights are currently structured to provide rights from the start of a winter period (in effect giving NGG a 48 month lead time on the delivery of capacity). In our view, this strategy would make the Net Present Value (NPV) test more difficult to pass because the near term periods are

⁷ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁸ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

⁹The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

those which are discounted the least (and therefore contribute the most) to the NPV calculation. As a consequence, we consider that the strategy is unlikely to be adopted by the majority of shippers or storage operators. Moreover, for the two incremental signals (Isle of Grain (2007) and Caythorpe (2008)) that have taken place since the introduction of a 42 month lead time, NGG has been able to use a summer build period to deliver capacity with a 36 month lead time. We consider that this demonstrates the appropriateness of having a final summer period for the delivery of capacity projects which require infrastructure to be built.

NGG also consider that both proposals could reduce the risks to which NGG is exposed as a result of the 2007-12 Transmission Price Control Review (TPCR 4) incentive framework for incremental capacity release. One respondent considered contractual risks to be lowered by the changes. Two respondents highlighted the impact on the residual value of the project permit incentive¹⁰. In our view, the impact on the permit incentive revenue is not clear cut. Whereas moving to a March QSEC should facilitate the delivery of capacity within the default lead time and therefore mitigates the risk of capacity being delivered late, NGG would need to commit to significant build during the winter (with all the risks/cost inefficiencies this entails) in order to benefit from significantly early delivery of the capacity.

Finally, it is reasonable to expect that the proposal will result in further benefits to the TBE process and more accurate network analysis and planning. However these effects are unlikely to be marked.

c) so far as is consistent with (a) and (b) the efficient discharge of the licensee's obligations under this licence.

We consider that neither modification would better facilitate this objective.

Several shipper responses argued that it is important that there should not be cases where the same strip of capacity is offered for sale at different AMSEC and QSEC reserve prices. In the current situation, there is a 6 month strip where AMSEC and QSEC prices can overlap, UNC230 has a 12 month overlap and UNC230AV has none. Further, NGG and others argue that overlapping prices might be viewed as inconsistent with the requirement of Standard Special Condition A5 to develop cost reflective methodologies.

Ofgem does not share these concerns. Within the entry capacity regime there are a wide range of different products to meet different needs. These products differ in the duration for which capacity may be bought, the times at which they can be bought and the certainty they provide to users. Hence, in our view, a quarterly product cannot be directly compared with a monthly product. Thus the fact that overlap occurs is of limited consequence for both the operation of the entry capacity auction system and charging.

d) so far as is consistent with sub paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and or (iii) between DN operators.

We consider that both modifications would better facilitate this objective.

¹⁰ The scheme as described in SLC C8D 3 (g) allows NGG to use permits to vary the lead time for the contractual delivery of incremental obligated entry capacity from the default lead time of 42 months.

Within the Final Modification Report it is argued that both proposals would reduce the risk that gas could be stranded offshore as a result of a failure to provide incremental entry capacity on schedule. It is argued that this would promote competition. As we have outlined above under objective (a) we consider that this proposal should improve the timeliness in the provision of incremental capacity. In turn, this should promote competition between shippers and should ensure that efficient sources of gas are not stranded or held back from the market.

In addition, in comparing modification proposals UNC230 and UNC230AV, we consider that unanticipated changes, such as the removal of a 2009 QSEC, could impact on the ability of Shippers to plan capacity holdings and hence on competition between shippers. This could potentially affect all shippers. In this sense, because UNC230AV would not result in the removal of the 2009 QSEC, it is likely to make a greater contribution to this objective.

It is argued by two shippers that the reduction in the AMSEC transaction period in UNC230 would be detrimental to this objective. However, we are not convinced of the strength of this effect.

Conclusion

Ofgem considers that the primary impact of UNC230/UNC230AV is to potentially reduce risks associated with new build incremental capacity release. This should lead to gains in terms of cost efficiency and improved timeliness. We also support the view of several respondents that the removal of the scheduled September 2009 auction would not have been anticipated at the time of the 2008 QSEC auction. We see this change as being potentially disruptive to shipper long-term capacity planning and potentially damaging to both competition between shippers and the economic and efficient operation of the pipeline. For this key reason we reject UNC230 and accept UNC230AV.

It is noted that two Shippers both in written response and at the time of the Panel vote were opposed to the reduction in the AMSEC transaction period in UNC230AV because of its perceived impact on booking strategies. However we consider that as the modification only affects the AMSEC from February 2010, the industry has time to reflect on and consider appropriate actions, including bringing forward suitable modification proposals, if these concerns remain.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC 0230AV: Amendment to the QSEC and AMSEC Auction Timetables be made.

Stuart Cook
Director - Transmission

Signed on behalf of the Authority and authorised for that purpose.