

Direct Dial: 020-7901 7437

19 July 2001

Transco, Shippers and Other Interested Parties

Your Ref:
Our Ref : Net/Cod/Mod/0461

Dear Colleague,

Modification Proposal 0461 'Amendment to Curtailment time for Interruptible Entry Capacity'

Ofgem has considered the issues raised in Modification Proposal 0461 '*Amendment to Curtailment time for Interruptible Entry Capacity*'. Ofgem has decided to direct Transco to implement the modification because we believe that this proposal will better facilitate the relevant objectives of Transco's Network Code. Ofgem expects that implementation of this modification will occur on 1 October 2001.

In this letter, we explain the background to 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 firm entry capacity to its National Transmission System (NTS). The auctions provided for the allocation of monthly system entry capacity (MSEC) to successful bidders for a total period of six months from 1 October 1999 to 31 March 2000. The second series of auctions was held in March 2000 for the six-month period of 1 April 2000 to 30 September 2000 and further series of auctions were held in August 2000 and February 2001. In addition to releasing MSEC, Transco also releases firm capacity both on a day-ahead and within day basis. The within-day capacity market was established in June 2000.

As well as firm capacity rights, Transco also makes available interruptible entry capacity rights on a monthly and a daily basis. In the event of a capacity constraint,

Transco is able to scale back such capacity rights. Monthly interruptible capacity rights were introduced following Ofgem's acceptance of Modification Proposal 0410 *'Auctions of Monthly Interruptible System Entry Capacity'*. Monthly interruptible capacity rights are sold by way of auction following the auction of firm monthly capacity rights and were introduced in response to concerns that insufficient capacity was being made available in the monthly auctions.

The last curtailment time for interruptible entry capacity rights is 24:00 hours on the Gas Flow Day. However, holders of firm system entry capacity rights may submit offers to sell those rights back to Transco up to 02:00 hours on the Gas Flow Day. As a consequence, between 24:00 and 02:00 on the Gas Flow Day Transco is unable to curtail interruptible entry capacity rights, even though it may buy back capacity.

The proposal

Transco proposes in Modification Proposal 0461 to bring forward the last effective curtailment time for interruptible entry capacity from 24:00 hours to 02:00 hours on the Gas Flow Day. In its opinion, this would remove the current inconsistency within the Network Code between the last effective time for curtailment of interruptible system entry capacity and the last effective time for the buy-back of firm system entry capacity. Transco believes that it should have access to both constraint management tools for as long as reasonably practical, allowing it to determine the most appropriate action to take in the event of a need to do so. Transco also believes that the proposal could potentially lead to a reduction in buy-back costs, which would benefit MSEC holders.

Respondents' views

Of the six responses received, a clear majority supported the proposal to align the curtailment time for interruptible system capacity with that for firm system entry capacity to 02:00 on the Gas Flow Day. Several of these respondents said that the proposal would redress an inconsistency within the Network Code that could potentially lead to the buying back of firm capacity while interruptible capacity remained available within day. One respondent noted that this possibility is at present a potential risk to MSEC holders because they incur 80 per cent of any buy-back costs.

One of the respondents who supported the proposal nevertheless noted that it entailed a slightly higher probability of interruption, which would lead to increased insecurity for shippers. This respondent suggested that the modification be implemented from October 2001 after the completion of the summer period.

One respondent opposed the proposal. In its view there is no absolute requirement for both capacity management tools to be available at the same time because the two products are fundamentally different. It said that the effect of pushing back the curtailment time for interruptible capacity rights forward to 02:00 hours would be to significantly reduce the time in which holders of such rights would be able to make the necessary adjustments to balance their positions. It contrasted this position with that of holders of firm rights who had willingly surrendered their available capacity. Such holders, it asserted, would have managed this position before entering their bid. It expressed the view that this two-hour period is of greater value to the party having capacity curtailed than to Transco.

This respondent did not share the view of Transco that there is a real increase in exposure to buy-back of firm capacity. In its opinion, the operation of the system would dictate that any curtailment of interruptible capacity taken by 24:00 hours would anticipate changes in the position through until the end of the gas day. It noted that there had never been additional buy-backs between 24:00 and 02:00 hours.

Transco's view

Transco expressed the view that it is inappropriate that users be permitted to flow gas under interruptible entry capacity whilst users holding firm entry capacity are requested to relinquish their rights, albeit at their own valuation. It stated that this could lead to greater buy back costs, which could result in an increased risk to MSEC holders, which would bear a significant proportion of the costs. Transco submitted that the greater uncertainty associated with the interruptible capacity product should be reflected in participant bids and valuations. In particular, bidders should accept that there is a risk associated with the product that flows could be curtailed in order to protect the interests of firm capacity holders. In this context, Transco was of the view that users would limit their use of interruptible capacity to cover those gas deliveries, which can be adjusted.

Ofgem's view

Ofgem considers that the curtailment times of firm and interruptible capacity should be aligned so that Transco has discretion under the scope of its incentive arrangements to determine the most appropriate and least cost action to manage system constraints. Under the present arrangements, this discretion has been limited in a manner that may increase the costs of constraint management. This limitation is inconsistent with the commercial incentive framework established through NGTA.

In addition, Ofgem considers that the presence of different curtailment times between firm and interruptible capacity may distort the relative values of these products. The alignment of curtailment times should instead ensure that the interruptible product is more efficiently valued by the market.

Ofgem recognises that the modification may result in a slight increase in uncertainty for holders of interruptible capacity. However, a fundamental feature of the interruptible product is the uncertainty over whether such a right will be curtailed or not. To the extent that this results in a more uncertain or risky product (given a shipper's ability to adjust flows in time), this should be reflected in the price at which shippers are prepared to bid for interruptible capacity rights. If shippers value increased certainty and reduced risk in capacity rights, they are able to bid for firm capacity rights.

Ofgem's decision

Ofgem believes that this proposal better facilitates the efficient and economic operation of the NTS by allowing Transco greater discretion under its incentive in its management of system constraints.

Accordingly, Ofgem has decided to consent to this modification, as we 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,

Mark Feather
Head of RGTA