Modification Report
Extend capacity period sold to 12 months in MSEC and MISEC auctions of February 2001
Modification Reference Number 0444

Version 4.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

The Proposal is that effective from 19 January 2001, auctions of MSEC and MISEC should make available capacity for a 12 month period. That period will be from 1 April of the year in which the relevant auction is held through to 31 March of the following year. It is Proposed that MSEC auctions be completed by not later than 15 February and that MISEC auctions be completed by not later than 28 February.

2. Transco's Opinion

Transco has raised this Modification Proposal to enable consideration to be given to moving to a 12-month cycle of entry capacity auctions for both MSEC and MISEC. The present 6-month cycle was introduced as an interim measure that was intended to mitigate risk to Users whilst they became familiar with aspects of the New Gas Trading Arrangements (NGTA) that had been introduced in October 1999.

Transco acknowledges that some Users have questioned whether such twelve month period should cover the October to September period (thereby achieving alignment with the traditional gas year). Transco believes that it is beneficial to proceed with proposal based on the April- March period which should be expected to provide greater certainty for industry players for the rest of the price control period. This might also be considered to have better alignment with proposals to sell longer term capacity on a "price control" year basis.

A 12-month cycle for entry capacity auctions will also create a longer window of opportunity for potential development of the Network Code prior to future auctions. At present Transco has initiated a programme of work to explore the possibilities of developing new auction types that could offer the potential for greater efficiency in the allocation process. Transco does not believe that the exploration could be driven to a successful conclusion in time to facilitate Industry discussion and development of new auctions before October 2000.

It is arguable that Users now have the necessary familiarity with auction processes to enable the period offered at auction to be extended to the full 12-months, in line with the original intent for NGTA. Transco acknowledges however that a number of Users may disagree with the latter proposition regarding familiarity with the auction process.

Transco notes that some shippers have suggested that it is essential that Ofgem completes and publishes the results of the investigation into the recent operation of the capacity regime, particularly in respect of recent buy-backs before a decision on this proposal could be made. Whilst Transco considers this would be preferable, Transco is mindful that awaiting the outcome of such investigation might prohibit the possible implementation of this proposal and hence Transco believes that this Modification Proposal should be considered by participants using all the information available to them at all stages of consultation

3. Extent to which the proposed modification would better facilitate the relevant objectives

Transco believes that an annual auction of MSEC and MISEC may fit better with producers' needs to plan gas production profiles and that discontinuities in capacity prices could be avoided, meaning that the proposal should enable more economic and efficient operation of the pipeline system.

4. The implications for Transco of implementing the Modification Proposal , including

a) implications for the operation of the System:

There are unlikely to be any implications for the operation of the system.

b) development and capital cost and operating cost implications:

No development costs are required to implement this proposal and operating costs are expected to remain unchanged.

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

No such costs have been identified.

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 to Transco under the Network Code as modified by the Modification Proposal

Transco does not anticipate any change to contractual risk as a result of this Proposal.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

No development implications are anticipated.

7. The implications of implementing the Modification Proposal for Users

Users would have an opportunity to obtain 12-months of MSEC and MISEC in the auctions of February 2001. This would require Users to determine their entry capacity requirements for a longer period than at present.

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

No implications are anticipated.

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

A greater level of contractual certainty may be gained from offering entry capacity for a 12-month period. Entry Capacity Prices would be known for a full 12-month period which may be advantageous for Users and Consumers when determining gas supply contracts. The approximate levels of post-auction adjustment to the NTS commodity charge should also be known for the 12-month period.

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

Advantages :
Production profiles may be planned for a longer period than had previously been possible.
Price discontinuities between winter and summer capacity may be reduced.
Greater contractual certainty may become available to Users and Consumers.

Disadvantages :
Users may need to plan their capacity requirements for longer than at present.
The consequences of unsuccessful bid strategies may become greater for Users.
An auction period of 1 April to 31 March would conflict with the traditional gas year of October through to September which may prove problematic with regard to shipper contracts with consumers.

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

Representations have been received from nineteen respondents. Five supported the proposal while fourteen expressed a view that the Modification Proposal should not be implemented.

For:
BP Gas Marketing
ExxonMobil Gas Marketing
TotalFinaElf Gas and Power
Scottish and Southern Energy

Conoco

Against:
TXU Europe Energy Trading
Yorkshire Energy
Alliance Gas
Powergen
Shell Gas Direct
Northern Electric Gas
British Gas Trading
Chevron
Marathon Oil
Aquila
Cinergy Global Trading
Association of Electricity Producers
BG Group
Innogy

Of those respondents in support of the proposal BP Gas Marketing indicated that it believes the proposal offers a good transition into the long term capacity regime commencing April 2002. It has been suggested by BP Gas Marketing that the proposal reduces the administrative burden on shippers and enables shippers to plan their capacity requirements for a longer duration. ExxonMobil Gas Marketing has indicated that as a matter of principle it believes that entry capacity should be made available as far ahead as possible to enable purchase for a period that is consistent with the period over which a shipper is able to make gas sales commitments to customers downstream of NTS entry points. It believes that auctions for a 12-month period represents limited progress towards securing this principle. ExxonMobil and TotalFinaElf Gas and Power also suggest that the time shippers save through a single 12-month auction can be re-invested to develop the long term entry capacity regime so that the terms for this will be available well in advance of April 2002. TotalFinaElf Gas and Power expresses a view that 12-month auctions will provide greater certainty and reduced price volatility when compared to the present format.

Seven respondents, including Marathon Oil, Powergen, Innogy, Cinergy Global Trading, Northern Electric Gas, Aquila and the Association of Electricity Producers (AEP) support in principle the extension of auctions to cover a 12-month period. They suggest that this would bring stability to entry capacity prices, the NTS commodity charge adjustment would be known for a full year and further time would become available for considered commercial developments between auctions. However, each has withheld support for the proposal because they are of the opinion that 12-month auctions should be aligned with the gas year and consequently they argue that the capacity period to be auctioned should commence on 1 October. AEP also draws attention to the possibility, if the proposal is implemented, of NTS commodity charge adjustments occurring in both April and October. It argues that a single commodity charge adjustment would be preferable and that could be achieved if the 12-month capacity period was aligned with the gas year. Powergen argues

that the industry has only had one set of summer auctions and one set of Monthly Interruptible System Entry Capacity (MISEC) auctions and therefore cannot be deemed to be familiar with auctions yet. TXU Europe Energy Trading (TXU), Shell Gas Direct, BG Group and Alliance Gas withheld support, in part because the proposed 12-month period is not in line with the gas year.

Yorkshire Energy, Northern Electric Gas and Shell Gas Direct believe that continuing with a 6-month auction cycle will enable Ofgem to complete their investigation into the operation of the capacity regime. They are concerned that approval of the proposal would remove any opportunity for improvements to the regime following the outcome of the Ofgem investigation.

Alliance Gas, British Gas Trading and Northern Electric Gas believe that continuation of the present 6-month auction cycle may be preferable because there is considerable debate going on within the industry particularly with respect to long-term investment signals, the introduction of New Electricity Trading Arrangements (NETA) and energy balancing.

Yorkshire Energy and British Gas Trading are concerned that a 12-month period offered at auction would increase the business risk for shippers. This concern is, they claim, exacerbated by an illiquid secondary capacity market that could limit the options for shippers to secure changing capacity requirements later in the year as their portfolio changes.

Alliance Gas suggests that the present process of auctioning 6-month capacity is retained until October 2002, after the price control review.

Shell Gas Direct and Aquila expressed concern that the industry has not been provided with adequate notice in order to plan for a 12-month auction and also consider that further time should have been allowed to explore more thoroughly how the present structure of auctions might need to be developed. Shell Gas Direct also sees merit in the measure of stability offered by continuing with an unchanged commercial environment.

Chevron believes that 12-month entry capacity auctions should be timed to fit with completion of the Base Plan Assumptions process which will then better inform all parties of the quantities to be offered at auction.

Scottish and Southern Energy, whilst supporting the proposal, requests that a number of changes should be considered for future auctions. In particular it would like the notice period for commodity charge adjustments (if appropriate) to be greater than one month. It would also appreciate clarification from Transco of the possibility of further changes to commodity charges from 1 October. BG Group oppose the proposal, in part, because in its view the proposal enshrines the NTS commodity charge adjustment methodology. That is a methodology which it believes creates perverse incentives for Users.

Transco's response:

Transco notes that a majority (eleven) of respondents support in principle a transition to 12-month auctions. However six respondents are of the opinion that it would be most appropriate for the auction period to coincide with the gas year starting 1 October. Transco recognises that the traditional gas year of October through to September remains a feature of many contracts throughout the gas business. However it also notes that competing claims can be made to align auctions with storage contracts. Contract periods can and do change to reflect developments in the business environment and Transco sees no particular reason to be constrained to holding auctions that are timed to coincide with external contractual periods. It does however see merit in operating auctions that are aligned with its Price Control Formula. This would enable a more efficient transition from the requirements of one formula period to the next and consequently maximise the effective period under which any revised conditions are intended to apply.

Transco notes only one respondent put forward the view that an insufficient number of auctions have been held for Users to be familiar with the process. Transco is of the view that the similarity between the various monthly auctions that have been held to date should provide shippers with the necessary degree of familiarity with entry capacity auctions to enable them to feel relatively comfortable with the transition to 12-month auctions.

It is not clear to Transco how the Ofgem investigation of events in October would be expected to affect the primary allocation of entry capacity. Transco's understanding is that the issues being investigated relate to the level of prices offered through the buy-back mechanism. This does not appear likely to be related to the period offered in the primary monthly capacity allocation.

Transco agrees with the observation that there is considerable debate to be held within the industry over the medium term regarding a range of issues. Rather than providing a reason for delay Transco is of the opinion that a high level of debate would be easier to manage through to successful development if this proposal is implemented. Users would then have certainty for a 12-month period regarding entry capacity allocation and would consequently be able to focus on other areas for development. For this reason Transco does not support the suggestion from Alliance Gas that the introduction of 12-month Auctions is delayed until October 2002.

Transco acknowledges that the consequences of a mistaken bid strategy could be greater in auctions for longer periods. However, any erroneous bid strategies will continue to be mitigated by the structure of the auctions whereby Monthly System Entry Capacity (MSEC) can be obtained in each of up to five rounds of bidding. Transco does share Users concerns regarding an apparent lack of liquidity in secondary capacity markets. As an alternative Users will continue to be offered the opportunity to obtain capacity from Transco on the day ahead and within day firm capacity auctions. In addition interruptible "Use it or Lose it" Capacity will continue to be offered.

Transco sympathises with Users' concerns for longer periods of debate and longer notice periods before implementation. The commercial environment

regarding the release by Transco of entry capacity has been changing rapidly over an 18-month period. If approved, this proposal should afford a measure of stability for the present rules governing the release of entry capacity and would also provide a platform for measured consideration of any future changes that may be implemented.

Chevron has correctly identified a tension between the process of producing the Base Plan Assumptions which are the present basis for determination of entry capacity quantities and the time at which entry capacity is offered. Should the Modification Proposal be implemented Transco would welcome views on the timing of the Base Plan Assumptions process.

Transco notes that Scottish and Southern Energy would like to extend the one month notice period prior to implementation of commodity charge adjustments. Introduction of a longer notice period is outside the scope of this proposal and consequently would require a further Modification Proposal.

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

Not applicable.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Not applicable.

14. Programme of works required as a consequence of implementing the ModificationProposal

Not applicable.

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

If approved, it is anticipated that this proposal could be implemented on 19 January 2001. Modification Proposal 0445 has been raised to propose a revised timetable for publication of MSEC quantities and should be implemented in tandem with this proposal.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of this proposal.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

19. Text

SECTION B: SYSTEM USE AND CAPACITY

Amend paragraph 2.3.1 to read as follows:

"….in the Capacity Year.".

Amend paragraph 2.3.2(a) to read as follows:

"….not later than 15th February in the Preceding Capacity Year; and….".

Amend paragraph 2.3.3 to read as follows:

"….in the Capacity Year on :".

Amend paragraph 2.3.4 to read as follows:

"(ii) the calendar month in the Capacity Year for which….".

Amend paragraph 2.3.5 to read as follows:

"….for each calendar month in the Capacity Year capable….".

Amend paragraph 2.3.7 to read as follows:

"For each calendar month in the Capacity Year:

….".

Amend paragraph 2.3.9 to read as follows:

"….for the calendar month in the Capacity Year in respect of….".

Amend paragraph 2.3.10 to read as follows:

"….as holding for a calendar month in the Capacity Year pursuant to….".

Amend paragraph 2.3.13(e) to read as follows:

"….

HC ….in the Capacity Year in which the calendar month falls.".

Amend paragraph 2.6.1 to read as follows:

"….in the Capacity Year.".

Amend paragraph 2.6.2(a) to read as follows:

"….shall not be later than 28th February in the Preceding Capacity Year; and….".

Amend paragraph 2.6.3 to read as follows:

"for a calendar month in the Capacity Year….".

Amend paragraph 2.6.4 to read as follows:

"(iii) the calendar month in the Capacity Year for….".

Amend paragraph 2.6.5 to read as follows:

"….for each calendar month in the Capacity Year….".

Amend paragraph 2.6.7 to read as follows:

"For each calendar month in the Capacity Year….".

Amend paragraph 2.6.9 to read as follows:

"….for the calendar month in the Capacity Year….".

Amend paragraph 2.6.10 to read as follows:

"….for a calendar month in the Capacity Year….".

Amend paragraph 2.6.13(e) to read as follows:

"….

MC is the greater of:

….

(a) ….any calendar month in the preceding Capacity Years;

(b) ….for the Capacity Year….".

SECTION W: INTERPRETATION

Amend paragraph 2.2.1 to read as follows:

(g) ….;

(h) "**Capacity Year**" means the period from 1st April in any year until and including 31st March in the following year.

(i) and in relation to a Capacity Year, the "**Preceding Capacity Year**" is the Capacity Year ending at the start of such Capacity Year.".

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Gas and Electricity Markets Authority Response:

> In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0444**, version **4.0** dated **19/01/2001**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **4.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:

   (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or

   (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

   provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.

2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.

3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.

4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.