



Shippers, Transco and other
Interested Parties

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Dear Colleague,

Modification Proposal 0616 'Revision to the Standard Year for purposes of acquiring and holding Annual Monthly System Entry Capacity'

British Gas Trading (BGT) raised modification proposal 0616 '*Revision to the Standard Year for purposes of acquiring and holding Annual Monthly System Entry Capacity*' on 18 February 2003.

Ofgem has carefully considered the issues raised in this proposal and has decided to direct Transco to implement this proposal because we consider that it better facilitates the relevant objectives of Transco's network code, as set under standard condition 9 of Transco's Gas Transporter (GT) licence.

In making this decision Ofgem has taken into account Transco's obligations under its GT licence, our wider statutory duties and all relevant facts.

We have set out below the reasons for our decision to direct Transco to implement modification proposal 0616.

Ofgem has also today issued its decisions on modification proposal 0617, '*Revision to the standard year for purposes of acquiring and holding long-term system entry capacity*' and modification proposal 0625, '*Short term six month auctions*'. Ofgem has directed Transco to implement modification proposal 0617 but has rejected modification proposal 0625. We have set out the reasons for these decisions in separate letters.

Background to the proposal

System Entry Capacity Auctions

Transco has allocated monthly system entry capacity (MSEC) rights to access the national transmission system (NTS) via six monthly entry capacity auctions since September 1999. The most recent MSEC auctions were held in February 2003 and covered a period from 1 April 2003 to 30 September 2003. Transco also releases firm and interruptible capacity on a daily basis where there is additional capacity available. In addition, in the event that expected flows exceed both the capability of the system at an entry point and the amount of capacity held by shippers at that terminal, Transco is able to scale back interruptible capacity and to the extent necessary, buy back firm entry rights at market determined prices.

Following Ofgem's approval of modification 0500, '*Long Term Capacity Allocation*', Transco also makes available quarterly system entry capacity (QSEC) rights to access the NTS up to 15 years ahead of use. The first long-term auction for the sale of QSEC from 2004 to 2017 was held in January 2003.

Following the implementation of modification 0500, Transco has an obligation to issue annual invitations for the MSEC and QSEC auctions not earlier than 1 August and not later than 31 August in each gas year¹.

The next series of long-term auctions is currently scheduled to occur in August 2003 for the period October 2005 to September 2018. The first annual monthly system entry capacity (AMSEC) auction is scheduled for August 2003 for the period October 2003 to September 2005. Both the AMSEC and the long-term auctions are currently operated on the basis of capacity years which are aligned with the traditional gas year and defined as the period from 1 October in any year until and including 30 September in the following year.

As such, the arrangements are not aligned with Transco's formula year which is the period from 1 April in any year until and including 31 March in the following year.

Transco's transportation charges

The modifications made to Transco's GT licence on 27 September 2002 established Transco's Transmission Asset Owner (TO) price control from 2002-2007 and put in place a series of System Operator (SO) incentives for the NTS. The modifications took effect from 1 April 2002 and separated the regulation of Transco's role as TO whereby it builds and maintains the NTS, from its role as SO whereby Transco

¹ The first long-term auction was held in January 2003 for the purposes of allowing shippers time to prepare to bid in the auctions, following the final implementation of modification 0500 in September 2002.

determines the need for additional capacity and operates the NTS on a day-to-day basis.

Transco levies transportation charges on shippers to recover its NTS allowed revenue as determined under its price control. In particular, Transco collects its NTS T0 allowed revenue through entry and exit capacity charges and its NTS S0 allowed revenue through an S0 commodity charge. Transco is required to use its best endeavours in setting its charges to ensure that, in respect of any formula year, the revenue from such charges does not exceed its price controlled maximum allowed revenue for each of its T0 and S0 controls.

Transco may need to adjust the level of its transportation charges periodically in order to ensure that it meets its price control obligations. Changes of this nature may be required in the event that Transco has incorrectly forecast its expected revenues for a formula year. In addition, where revenues received from entry capacity auctions suggest that Transco may exceed its allowed revenue for a particular year, charges may be adjusted to ensure Transco does not over recover against this allowed revenue.

Under the provisions of its GT licence, Transco must use reasonable endeavours to give the Authority notice of a proposal to change its charges at least 150 days before the proposed date of implementation.

Further, under the current network code arrangements, Transco is required to provide no less than two months notice prior to the implementation of any revised transportation charges.

Ofgem has previously indicated that Transco should give consideration to revising its transportation charges once a year only, with sufficient notice being given to shippers of this change.² In particular, Ofgem has stated that restricting changes to transportation charges on an annual basis would facilitate competition in the wholesale gas market.

Provision of maintenance information

Transco is currently required, under Section L of the network code, to prepare and publish a maintenance programme outlining planned maintenance of the NTS. The maintenance programme identifies the duration and expected impact of planned maintenance on Transco's ability to accept gas deliveries or to make gas available for offtake.

² See for example, Ofgem's decision letter with respect to Transco's Pricing Consultation paper PC 75, 'NTS T0 Commodity charge' and Ofgem's decision letter approving network code modification proposal 0576, 'Provision of information relating to the S0 commodity charge'.

Transco is required each year to prepare and publish a maintenance programme for the planning period commencing 1 April ('the April Maintenance Programme') and an updated maintenance programme for the planning period commencing 1 October ('the October Maintenance Programme').

The network code provides that the April and October Maintenance Programmes cover planning periods of 24 months from 1 April and 1 October respectively.

In its Maintenance Programmes Transco is required to provide details of firm maintenance periods and details for the first seven months of the planning period (in the case of an April Maintenance Programme) or six months (in the case of an October Maintenance Programme) of the planning period, as well as provisional maintenance periods and details for the second five/six months respectively. Transco is also required to outline details of maintenance for the last 12 months of the planning period.

Users are required under the network code to provide information to Transco, including estimates of their expected gas deliveries and offtakes and the extent to which they could vary deliveries by delivering quantities to other entry terminals.

Transco is required to publish a draft April Maintenance Programme by 1 February in each year, following its receipt of users' information by 30 November in the preceding year. It is then required to publish its April Maintenance Programme by 1 April, after holding a meeting with industry participants by 1 March. Users are required to provide updated information to Transco by 30 June in each year, in order for Transco to prepare its draft October Maintenance Programme by 1 September. Transco is required to publish the October Maintenance Programme by 1 October, following the submission of Users' comments. These comments are required to be submitted by 15 September.

In addition, following the implementation of modification proposal 0560, '*P u b l i c a t i o n o f I n d i c a t i v e M a i n t e n a n c e S c h e d u l e*', Transco is now also required to prepare an indicative maintenance programme for the period of 12 months commencing from 1 October of any gas year at least one week ahead of the annual entry capacity auctions for that period. In approving this proposal Ofgem stated that the publication of indicative maintenance information would assist shippers in efficiently valuing entry capacity and should better facilitate the economic and efficient operation of Transco's pipeline system by providing Transco with valuable information on the value that shippers place on capacity during periods of maintenance. This should in turn assist Transco in efficiently

determining whether to adjust its maintenance programme to minimise the costs associated with capacity buy-backs.

Related modification proposals

Separate to this proposal BGT has also raised modification proposal 0617, '*Revision to the Standard Year for purposes of acquiring and holding Long Term System Entry Capacity*'. This proposal provides that the long term system entry capacity allocations are held in September of each year and would offer capacity for the period April (Y+2) to March (Y+16).

In addition, Shell Gas Direct has raised modification proposal 0625, '*Short term six month auctions*' which provides that the AMSEC auctions are held every six months, namely in February for April to September capacity and in August for October to March capacity with long-term auctions held in September each year.

The proposal

BGT has proposed a revision to the timing of the AMSEC auction process in order to align the sale of capacity with Transco's formula year and baseline capacity periods. BGT suggested that the AMSEC auctions occur in February of each year, from 2004, for capacity for the following April (Y) to March (Y+1). BGT noted that this would also require transitional arrangements including the holding of a further 6 monthly MSEC auction in August 2003 in order to offer capacity for the period October 2003 to March 2004.

Respondents' views

The majority of respondents supported the proposal, although a number offered qualified support, with some expressing concern that there would be a reduction in the notice period for changes to charges if the AMSEC auctions were held in February.

Several respondents, including those expressing qualified support, noted that aligning the baseline quantity year with the formula year would ensure that the annual MSEC process would occur at a time when there is more reliable information on matters such as Transco's and producers' offshore maintenance.

One respondent also noted that holding auctions for the following gas year each summer is inefficient as producers have not defined their shutdown dates for the following summer when buying capacity. Therefore holding an auction in February is desirable as producers' summer shutdown plans will be more mature.

Several respondents suggested that aligning the capacity year and formula year would remove the step change in baseline quantities

that currently exists. Several respondents also commented that the proposal would be likely to lead to less mid-year changes in transportation charges, thereby bringing increased stability which should facilitate competition between shippers and suppliers.

Some respondents that expressed qualified support for the proposal outlined concerns that a consequence of holding auctions in February would be a permanent reduction in the notice period for changes to charges to only one month. It was noted that a reduction in notice periods would not be in the interests of customers or suppliers as it would increase the uncertainty in total gas costs in any tender processes. In this context some respondents suggested that the auctions occur in January and that, with this in mind, Transco could be required to publish an indicative maintenance programme in December.

Of those respondents who did not support the proposal, one stated that there is value in retaining the alignment of the capacity year with the gas year given existing contracts. This respondent also stated that it would be difficult for shippers to forecast flows from October in any gas year as early as February in that year.

Another respondent who was against the proposal stated that whilst it may improve Transco's initial forecast of transportation costs, the true impact of the capacity regime, with auctions being held up to the gas day, may lead to further changes in transportation charges in any event.

This respondent also suggested that the interim arrangements would be inappropriate as they create a step change in capacity volumes available.

Transco's views

Transco offered support for this proposal.

Transco noted that participants in the MSEC auctions would have the most up to date information available on the NTS maintenance programme for the following summer period, although the annual maintenance plan at that time would be indicative only.

Transco also stated that the proposal would also allow shippers more time to consider the outcome of the earlier long-term system entry capacity auctions in preparing their bids.

It considered that the alignment of the capacity year and formula year could deliver some benefits such as better forecasting of over or under recoveries associated with auction revenue, as well as removing the step change in the baseline quantities that presently exists over the 12 month period. Transco agreed that the proposal might reduce the likelihood of mid-term price changes if prices were

set to take effect from 1 April following the results of the annual MSEC auction held in February.

Transco has suggested that if implemented, in order to hold an auction in February and consult on any consequential changes to charges before 1 April, this modification would require a further change to the network code in order to reduce the notice period for changes to charges from the current two months period to one month. However Transco also noted that as an alternative any price changes might be implemented after the start of the formula year. Transco recognised that this subject would be open to discussion outside of the remit of this proposal.

Ofgem's views

Ofgem agrees with the majority of respondents that this proposal should enable Transco to obtain a better forecast of its revenues for a relevant formula year. In particular, by holding the AMSEC auctions in February, Transco should be provided with better information regarding its likely revenue flows for the forthcoming formula year relative to that which would be provided following a July or August AMSEC auction. Ofgem therefore considers that this information should assist in reducing the possibility of mid-year changes in transportation charges thereby facilitating charging stability. In this regard, as noted previously, Ofgem considers that by facilitating charging stability the proposal should better facilitate competition between relevant shippers and suppliers.

Ofgem notes the concerns expressed by respondents that it is undesirable to reduce the notification period for adjustments to transportation charges as set out in the network code. In this respect Ofgem agrees that adjustments to this notice period may increase uncertainty for shippers and customers in terms of transportation charges which may undermine competition to the detriment of customers. Conversely however, we also recognise that there may be occasions where it is appropriate to waive these notice periods, for example to prevent potential distortions in competition in addressing over or under recoveries.

With this in mind, Ofgem considers that it is appropriate to consider proposals to waive notice periods on a case by case basis. Further, Ofgem considers that, of itself, this modification would better facilitate competition between shippers and suppliers irrespective of issues relating to notice periods. At present therefore, we do not believe it is necessary to provide a concluded view on this issue as no proposal on notice periods has yet been made. Clearly, a possible solution may be to bring forward AMSEC auctions to January. However, this would need to be the subject of a separate modification proposal.

In assessing this proposal, Ofgem accepts the views expressed by most respondents that conducting AMSEC auctions early in the year would be beneficial to the extent that participants have more reliable information on matters such as Transco and offshore maintenance which occur over the summer period. Ofgem notes that Transco has obligations to publish its draft April Maintenance Programme by 1 February every year. Whilst this may enable participants to have access to maintenance information by the time the auctions are conducted, Ofgem believes that consideration could be given to proposals that provide for this information to be published earlier (eg January or December) such that shippers have better notice of the proposed maintenance programmes in preparing their bidding strategies.

In this respect, Ofgem would reiterate the views it has previously expressed, that the publication of up to date maintenance data ahead of the MSEC auctions should assist shippers in efficiently valuing capacity thereby better facilitating competition. It should also better facilitate the efficient operation of Transco's pipeline system by enabling Transco to adjust its own maintenance programme and minimise buy-back costs in response to bids received in the entry capacity auctions.

Ofgem's decision

Ofgem has carefully considered the issues raised by this modification proposal in relation to the forthcoming AMSEC auctions. We consider that this modification will better facilitate the achievement of the relevant objectives as set out under amended standard condition 9 of its GT licence. In particular, conducting AMSEC auctions in February should facilitate charging stability by providing Transco with better information regarding its likely revenue flows for the forthcoming formula year. This should better facilitate competition between shippers and suppliers.

Further, conducting AMSEC auctions in February will allow shippers access to more reliable planning and maintenance information for the summer months which should enable shippers to value capacity more efficiently. This should better facilitate competition between shippers and should assist Transco in determining whether to adjust its own maintenance programme to minimise capacity buy-back costs, thereby better facilitating the efficient and economic operation of Transco's pipeline system.

Accordingly Ofgem has directed Transco to implement this modification, as we consider that it would better facilitate the achievement of the relevant objectives as outlined in amended standard condition 9 of its GT licence. In particular, the proposal would better facilitate the achievement of the securing of effective

competition between relevant shippers and between relevant suppliers.

If you require any further information in relation to this modification please feel free to contact me on the above number or Tolani Azeez on telephone 0207 901 7043.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Mark Feather', with a stylized, cursive script.

Mark Feather
Head of Gas Trading Arrangements