



Shippers, Transco and Other
Interested Parties

*Bringing choice
and value to
customers*

Our Ref: net/cod/mod/0622
Direct Dial: 020 7901 7437
Email: mark.feather@ofgem.gov.uk

21 July 2003

Dear Colleague,

Modification proposal 0622 'LTSEC for new entry points'

Transco raised modification proposal 0622 '*LTSEC for new entry points*' on 17 March 2003.

Ofgem has carefully considered the issues raised in this proposal and has decided to direct Transco not to implement this proposal because we do not consider that the proposal will better facilitate the achievement of the relevant objectives of Transco's network code, as set under amended standard condition 9 of Transco's Gas Transporter (GT) licence.

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

We have set out below the reasons for making our decision.

Background

System entry capacity and Transco incentives

Transco allocates entry capacity rights to its National Transmission System (NTS) through a series of long and short term auctions. Under the entry capacity regime established in Transco's GT licence, Transco is funded to provide a series of baseline output measures of entry capacity for each system entry point. These baseline output measures are based on the maximum physical capability at each system

entry point and are referred to as Transco's transmission asset owner (TO) baseline output measures. Transco is obliged to offer 90 per cent of these output measures (system operator (SO) output measures) for sale as entry capacity rights.

Under its GT licence, Transco has an SO entry capacity investment incentive, which enables it to earn a rate of return of up to 12.25 per cent on ex-ante estimates of the cost of providing obligated incremental entry capacity rights (based upon unit cost allowances or (UCAs)) at each entry point. These rights are additional to the SO baseline output measures, and can be released where there is demand for such capacity signalled in auctions and following an application by Transco, under its GT licence, to Ofgem demonstrating that it has met the criteria for the release of this capacity as set out in its Incremental Entry Capacity Release methodology.

Entry capacity auctions

Following Ofgem's approval of modification 0500, '*Long-Term Capacity Allocation*', in September 2002, Transco makes available the SO output measures through auctions of quarterly system entry capacity (QSEC) rights that enable shippers 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 implementation of modification 0617 '*Revision to the Standard Year for purposes of acquiring and holding Long-term System Entry Capacity*' the next long-term auction is scheduled for September 2003, auctioning capacity from 2005 to 2018 in alignment with the April to March capacity year. Under Transco's network code, Transco is required to invite applications for QSEC not earlier than 1 September and not later than 30 September each year.

Following Ofgem's decision to direct Transco to implement modification 0616 '*Revision to the Standard Year for purposes of acquiring and holding Annual Monthly System Entry Capacity auctions*,' annual monthly system entry capacity (AMSEC) auctions will be held in February of each year. Transco will offer for sale capacity from the April (Y) to March (Y+1) compared with previous MSEC auctions, which related to the sale of capacity from October to September in line with the gas year.

Notification of reserve and step prices for long term auctions

Under the current network code arrangements, Transco has an obligation to notify shippers of the reserve prices and the step prices that will apply in respect of each Aggregate System Entry Point (ASEP) not later than 28 days before the first annual invitation date for the long term auctions.

New system entry points

Following the conclusion of Transco's 2002-2007 price control review a number of parties approached Transco and Ofgem with proposals to bring additional gas supplies into Transco's NTS and with proposals to develop storage facilities. As a consequence, Ofgem issued a consultation and explanatory document on new entry terminals to Transco's NTS¹. The consultation, under section 23 of the Gas Act, sought to amend Transco's GT licence to include new UCAs for Milford Haven and Barton Stacey. This consultation was accompanied by an explanatory document on new entry terminals to Transco's NTS.

Ofgem is currently considering responses to the June licence consultation document and expects to release its decision on the proposed modifications shortly.

The proposal

Transco proposes that following the publication of a schedule of step prices for a new ASEP in Transco's Gas Transportation Charges statement, an additional long-term system entry capacity auction would commence within a 28 to 60 business day window. The additional long term auction would only offer capacity at the new entry point as opposed to all ASEPs. Transco has also proposed that the additional long term system entry capacity (LTSEC) auction should not take place if the publication of the price schedule occurs within 100 business days of the first day of the month in which the annual LTSEC auctions would take place.

Respondents' views

Conducting additional LTSEC auction at new ASEPs only or at all ASEPs

The majority of respondents opposed offering capacity at all ASEPs. Several respondents suggested that capacity offered at new entry terminals could be offered separately from capacity at existing ASEPs. One respondent suggested that the decision to auction capacity at new and/or new and existing ASEPs should be decided on a case by case basis. Another stated that it was appropriate to offer entry capacity solely at the new ASEP provided that there were no significant implications for other terminals. Some respondents stated that holding additional auctions for existing as well as new ASEPs would increase uncertainty, with one respondent commenting that the introduction of unplanned additional opportunities to purchase capacity would create difficulties in formulating bidding strategies.

¹ *New entry terminals to Transco's National Transmission System Ofgem's views on Transco's proposals and explanatory notes to accompany the section 23 notice of proposed modifications to Transco's gas transporter licence, Ofgem, June 2003*

A number of respondents noted that there was no benefit in allowing new terminals to auction capacity at different times from existing ASEPs. One respondent stated that when entry capacity is to be offered at new ASEPs it should also be offered at all other ASEPs. However, the respondent also commented that shippers would, in any event, have further opportunities to bid for LTSEC at existing ASEPs in subsequent LTSEC auctions. Another respondent said that, as Transco does not have to physically provide capacity at an ASEP, there is no benefit in allowing new terminals to auction capacity at different times to existing ASEPs, as holding auctions at different times has little impact on a shipper's ability to acquire capacity.

28 - 60 day auction start date window

The majority of respondents supported arrangements whereby Transco is obliged to offer capacity between 28 days and 60 days from the date of publication of the price schedule for the new ASEP.

100 day window between auctions

Several respondents considered that the 100 day window was appropriate to prevent LTSEC auctions taking place in unnecessarily quick succession. However, some respondents expressed concern at this aspect of the proposal.

One respondent considered that a 100 day window between auctions may represent an unreasonable risk for shippers developing new terminals and connecting infrastructure and could actually hold up finalisation or letting of contracts with potential supply consequences. The respondent suggested that a more flexible approach was necessary and considered that the process of determining an auction date for a new entry point requires reasonableness checks that should be undertaken by Transco and Ofgem potentially in response to a proposal raised by a shipper associated with the new development.

Another respondent considered that the proposal as a whole was unduly prescriptive and commented that it would be more sensible to time the auctions in line with participants' requirements, relying on them to raise modifications as and when shippers require new capacity.

Additional comments

One respondent commented that the proposal did not provide enough information about the capacity to be offered in the additional auctions. Another respondent questioned whether shippers would need to participate in an additional long-term auction for new capacity once the price schedule had been published. The respondent

suggested that developers and shippers should have the information needed to determine the likely cost of entry capacity at the proposed ASEP and shippers should be confident that the appropriate level of capacity will be made available at the next long-term auction.

Transco's views

Transco welcomed support for this proposal. Transco considered that the proposal would facilitate the development of new entry points, as it would provide an opportunity for entry capacity to be allocated at an early stage. In particular, Transco commented that if it were to delay any new ASEP capacity release to the annual LTSEC auction this could represent a delay in the development of new entry points. As such Transco considered that the proposal would increase the possibility that capacity in the transmission system is enhanced in a timely manner thereby promoting security of supply.

It considered that by implementing this proposal both shippers and developers would have certainty within the auction process and would better understand the lead times for auctions. Transco also considered that this proposal would not rule out shippers raising further modification proposals in order to meet specific shipper / developer needs. However, Transco considered that any such proposals may not be raised in sufficient time within the project management time scales for establishing a new entry point, given the need for a shipper and developer to reach necessary agreements prior to bringing forward a proposal.

Ofgem's views

Ofgem recognises that this proposal is intended to create certainty for shippers and developers in determining the scheduling of auctions and the time between such auctions. However, we consider that the proposal is unduly prescriptive in nature and does not better facilitate the relevant objectives set out in standard condition 9 of Transco's GT licence.

In particular, Ofgem is concerned that the implementation of this proposal could artificially restrict the necessary flexibility for those shippers associated with new entry point developments to be able to secure capacity at new entry points in line with their own individual project timelines. As such, the proposal may be considered to be unduly restrictive to the development of new projects and therefore would be contrary to the achievement of effective competition between relevant shippers and relevant suppliers.

For example, having considered the views of respondents, Ofgem has concerns that the 100 business day requirement Ofgem could lead to

unnecessary delays in the allocation of entry capacity at a new entry point thereby potentially increasing costs for developers and impacting upon competition between shippers and suppliers. Whilst Ofgem recognises that some separation in the timing of LTSEC auctions is appropriate to enable allocations to be completed, we are not satisfied that the 100 day requirement is necessary to achieve this.

Ofgem recognises that a number of shippers and developers may require additional auctions for new entry points outside of the annual long-term auction timetable. Ofgem considers that requirements for any such additional auctions can be accommodated through specific modification proposals so that each request for an additional auction can be considered on a case by case basis.

Ofgem's decision

For the reasons outlined above, Ofgem has directed Transco not to implement this modification because we do not consider that it would better facilitate the achievement of the relevant objectives as set out in amended standard condition 9 of Transco's GT licence. In particular, Ofgem is not satisfied that a pre-set auction timetable for new entry points would better facilitate the securing of effective competition between relevant shippers and relevant suppliers or the efficient and economic operation of Transco's pipeline system.

If you require any further information in relation to this modification proposal please feel free to contact me on the above number or Tolani Azeez on telephone 020 7901 7043.

Yours sincerely



Mark Feather
Head of Gas Trading Arrangements