Shippers, Transco and other interested parties

Bringing choice and value to customers

Our Ref: net/cod/mod/0680
Direct Dial: 020 7901 7008
Email: Andrew.walker@ofgem.gov.uk

08 April 2004

Dear colleague,

Modification proposal 0680 'Recompense in the event of late completion of works for new system entry points'

Transco raised modification proposal 0680 'Recompense in the event of late completion of works for new system entry points' on 12 December 2003.

Having considered the issues raised in this modification proposal and all responses received Ofgem has decided to direct Transco to implement this proposal as it would allow Transco to better facilitate the relevant objectives as set out under standard condition 9 of the Gas Transporter (GT) licence.

In making this decision, Ofgem had regard to Transco's obligations under its GT licence, its wider statutory duties and all relevant facts.

The reasons for this decision are set out below.

Background

Transco's network code provides for firm financial rights for shippers who acquire firm entry capacity rights. In the event that the volume of firm entry capacity rights exceeds the physical capability available of the NTS ,Transco must buy back such firm capacity rights (after interrupting any interruptible capacity rights), either in the daily buy-back market or in advance through its capacity management agreements. Transco faces an incentive to minimise the costs of buy-backs through its buy-back incentive scheme.

The current buy-back arrangements do not protect shippers in the event of non-provision of capacity at new entry points. Prior to the connection of the facilities to the NTS, Transco would not be obliged to utilise its system management tools, such as buying back entry capacity rights.

In Ofgem's June 2003 document[1] Ofgem considered that it would be necessary to make alternative arrangements to cover the case of non-connected entry terminals with respect to the non/late delivery of entry capacity. Such arrangements would provide some protection to shippers acquiring entry capacity rights at the new terminals and to project developers. Ofgem stated that these arrangements would need to ensure that Transco faced appropriate incentives to provide physical capacity at new entry terminals in a timely manner.

Related modification proposal

British Gas Shipping (BGS) raised modification proposal 0682 'Recompense in the event of late completion of works for new entry point capacity' on 25 February 2004. Under this proposal, Transco would be required to enter into a capacity management agreement with new system entry points, providing Transco with the ability to signal and manage constraints due to the late completion of works and providing shippers with defined compensation rights. BGS proposed that the compensation rights should represent a proportion of the losses likely to arise to each shipper and could be viewed as a suitable incentive for timely completion of the works.
Ofgem published its decision on modification proposal 0682 today.

The proposal

Transco raised this modification proposal on 12 December 2003. Under this modification proposal, for each gas day for which gas cannot be accepted for delivery due to the non-completion by Transco of the connection between a new entry point and the gas transmission system, shippers would not be invoiced for their allocated system entry capacity at the new entry point. This does not include circumstances where third party works (excluding Transco's sub-contractors) that are required in order to allow gas to be accepted for delivery are not complete, regardless of whether Transco's works are complete.

Respondents' views

There were eight responses to this modification proposal. The majority of respondents supported the proposal, although several offered qualified support. One respondent was against the proposal.

Level of compensation

The majority of respondents expressed their concern regarding the level of compensation offered in this modification proposal. Most respondents stated that the amount of recompense offered in this modification proposal was not sufficient to cover expected losses suffered by users.

Further proposals

A number of respondents considered that this proposal should be only a starting point and that it should be supplemented by other remedies. The proposed alternative/supplementary measures included:

- a regime based on a multiplier of the price of capacity (a multiple of 8 was suggested)

[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

- contractual arrangements or agreements outside the network code
- strong incentives on Transco to complete its works on time, and possibly some kind of buy-back arrangements, with some provisions to mitigate Transco's exposure, namely:
    - mitigation of Transco's exposure to buy-back costs through provisions within procurement contracts
    - scope for Transco to apply for an income adjusting event, when cause of the delay is beyond the control of Transco and its contractors
    - regulatory oversight of the process
- extend the proposal to Monthly System Entry Capacity (MSEC) holdings.

Additional views

Respondents who offered qualified support were concerned that the modification proposal does not provide shippers with an adequate level of compensation. One respondent stated that its support was conditional on Transco's acceptance that this would only be the first step in developing an appropriate remedy and requested that the legal text be amended accordingly.

Transco's views

Transco, as proposer, offered support to this modification proposal. It recognised that under the current network code arrangements, there is no mechanism that provides for compensation for shippers in the event of late delivery of capacity at new entry points.

Transco considered that the buy-back mechanism is inappropriate for new aggregate system entry points (ASEPs), as Transco would have to buy back all the sold capacity regardless of actual intended flow rates and hence would be a distressed buyer.

Transco stated that this proposal would increase its incentives in circumstances where it was obligated to provide entry capacity by an agreed date, since otherwise it would suffer a loss of revenue for each gas day for which works are late.

Transco also believed that the assurance of recompense, as set out in this modification proposal, would encourage shippers to participate in entry capacity auctions.

Amount of recompense

Transco considered that the amount of recompense under this modification proposal was reasonable as it aligned potential risk to potential rewards.

Further proposals

Transco considered that the network code would be the most appropriate place for resolution of any issues arising from late completion of works and therefore disagreed with the proposal for separate agreements.

Transco noted that the NT&T workstream recognised that the proposal needed no further developments, but that possible alternatives may be developed by the industry in due course. Transco considered that the implementation of this proposal would give reassurance to project backers that it had a sufficient incentive to minimise the risk of late availability of entry capacity.

Ofgem's views

Ofgem supports this proposal.

Ofgem recognises[2] that it seems necessary to make alternative arrangements to cover the case of non-connected entry terminals with respect to the non / late delivery of entry capacity. Such arrangements would provide protection to developers and shippers and would ensure that Transco faces appropriate incentives in its commitment to provide firm entry capacity rights for parties wishing to connect to the NTS.

Ofgem notes concerns raised by shippers about the level of the compensation offered in this modification proposal. It is Ofgem's view that this proposal does not offer compensation. It effectively nullifies the contract between shippers and Transco in case of late delivery of capacity at new system entry points.

Given the absence of arrangements in the event of non provision of capacity at new entry terminals, we consider that this modification proposal better facilitates the achievement of the relevant objectives, as set out in standard condition 9 of Transco's GT licence, by providing arrangements for late delivery of capacity at new entry terminals. In particular, Ofgem believes that the implementation of this modification proposal would facilitate the efficient and economic operation of Transco's pipeline system and the securing of effective competition between relevant shippers and suppliers.

While accepting this proposal, Ofgem recognises shippers' requests for additional arrangements in order to provide a satisfactory level of compensation. Therefore, we would welcome further debate and offer due consideration to modification proposals from industry members. Ofgem recognises that further modification proposals may supersede the remedies established through this modification proposal.

Ofgem's decision

Ofgem has directed Transco to implement this modification proposal, as we consider that it would better facilitate the efficient and economic operation by the licensee of its pipeline system and the securing of effective competition between relevant shippers and suppliers, as outlined in amended standard condition 9 of Transco's GT licence.

If you require any further information in relation to this modification please feel free to contact me on the above number or Tolani Azeez / Matteo Guarnerio on telephone 0207 901 7043/ 7493.

Yours sincerely

Andrew Walker
Director, Transmission Networks Regulation

---

[2] See *'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'*, June 2003