Shippers, Transco and other interested parties

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Our Ref: net/cod/mod/0682
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08 April 2004

Dear Colleagues,

Modification proposal 0682 'Recompense in the event of late completion of works for new entry point capacity'

British Gas Shipping (BGS) raised modification proposal 0682 'Recompense in the event of late completion of works for new entry point capacity' as an urgent modification on 19 February 2004. Ofgem granted urgency to this proposal on 24 February 2004.

Having considered the issues raised in this modification proposal and all responses received Ofgem has decided to direct Transco not to implement this proposal because it would not 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 entry capacity financial rights for shippers. In the event that the volume of firm entry capacity rights exceeds the physical capacity available on the NTS (a transportation constraint), 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.

However, the current buy-back arrangements do not protect shippers in the event of non-provision of capacity at new entry points. Prior to connection of a new entry point to the system, Transco would not face a physical transportation constraint on the NTS because the gas would physically not be able to flow. In the absence of a physical constraint on its system, Transco would not be obliged to utilise its system management tools, such as buying back entry capacity rights.

In its 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 capacity at new entry terminals in a timely manner.

The June document recognised that these arrangements would be necessary in order to provide protection to shippers with firm entry capacity rights at new terminals. These arrangements could take the form of a liquidated damages agreement between the parties, to cover the period between Transco's obligation to first deliver capacity and the time at which Transco can physically accommodate gas flows from a new terminal.

At that time, Ofgem considered that such an agreement could be ancillary to the network code and could approximate some proportion of anticipated losses arising from the late / non delivery of new entry capacity.

Related modification proposal

Transco raised modification proposal 0680 'Recompense in the event of late completion of works for new entry terminals' in December 2003. Under the proposal relevant shippers would not be invoiced for their allocated system entry point due to non-completion by Transco of the connection between a new system entry point and the gas transmission system. The proposal would not provide a remedy for circumstances where third parties (excluding Transco sub-contractors) had not completed the relevant work. Ofgem published its decision on modification proposal 0680 today.

The proposal

Under BGS's 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 shippers with defined compensation rights. BGS proposed that the compensation rights should represent a proportion of the losses likely to arise for each shipper and could be viewed as a suitable incentive for timely completion of the works.

In Ofgem's response to the request for urgency, Ofgem asked respondents to comment on specific terms in the modification proposal and to propose alternative terms where they considered it appropriate. In particular, Ofgem invited comments on the proposed provisions for Transco to be exposed to any damages suffered for a 12 month period; whether eight times is the relevant factor for the daily price of non delivered capacity; whether an additional cap on damages set at the level of expected losses or costs caused to the shipper by the delay in provision of capacity and whether the compensation arrangements should be terminated if new capacity was still unavailable 12 months after the entry capacity allocation date.

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[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

Respondents' views

Eleven responses were received in relation to this proposal. The majority of respondents supported the proposal. One respondent did not support the proposal.

In summary,

- respondents considered that 12 months of pre-set exposure to daily liquidated damages seemed reasonable and offered a sufficient performance incentive on Transco to ensure that it and its contractors deliver new entry point capacity on time;

- several respondents recognised that the eight times daily capacity price factor could be considered to be arbitrary. One respondent considered that the factor could penalise both Transco and shippers, if costs were passed through the system operator buy-back incentive arrangements. One respondent offered an alternative proposal which would allow shippers to surrender capacity to Transco under the current network code arrangements. It considered that the offers submitted to Transco should reflect the costs incurred by shippers as a result of capacity not being made available.
  Several respondents supported the proposed eight times daily capacity price factor. They considered that it would align with the existing overrun regime;

- respondents considered that it seemed reasonable to provide a cap on the level of compensation which would be set at the level of expected losses or costs incurred by the affected shippers. One respondent supported the concept of compensation for losses only applying to those shippers who would have been in a position to flow gas. However several shippers identified that it would be difficult to quantify 'estimated losses'; and

- most respondents were satisfied with the proposal for a capacity management agreement which would be terminated if works were not completed within 12 months of the capacity allocation date. One respondent considered that it would be for Transco to seek an extension to this period via a network code modification proposal. Respondents offered varied interpretations as to whether Transco would be exposed to buy backs after 12 months, where capacity was still unavailable. One respondent considered that the capacity management agreement could be terminated after six months.

Overall respondents considered that the proposed arrangements were necessary to mitigate losses in the event of delays in the construction of connections to the new entry points.

Transco's views

Transco did not support this proposal. Transco considered that the proposed level of payment would be disproportionate, since under the current incentive arrangements the risks of building new infrastructure were greater than the rewards. It also considered that the link to overrun charges was inappropriate.

In addition, Transco considered that its exposure to liquidated damages would be passed through the system operator (SO) buy-back incentive and that therefore the current incentive target would need to be reconsidered.

It noted that any additional risk of exposure to compensation as a result of delayed project completion could inflate construction costs and potentially extend construction lead times.

Ofgem's views

Ofgem recognises the merits of liquidated damages for the late or non delivery of new entry capacity. However, after giving due consideration to all of the components of the proposal, Ofgem does not support this proposal.

While there is considerable support for the concept of compensation for losses suffered by shippers, Ofgem does not consider that interested parties have provided evidence that the parameters of this proposal (in particular the eight times daily price factor) appropriately balance the need to provide incentives for Transco to complete new entry terminals in a timely manner, protect Transco from undue risk and provide shippers with compensation for the late delivery of entry capacity.

Ofgem considers that shippers could be exposed to substantial costs where Transco seeks to recover its losses under the current incentive parameters for SO buy-backs costs. Ofgem does not consider that this would facilitate effective competition between relevant shippers and suppliers.

There would be substantial merit in shippers and or Transco developing an appropriate mechanism which would provide an incentive on Transco to build and deliver capacity on time and which would also provide appropriate compensation measures for shippers.

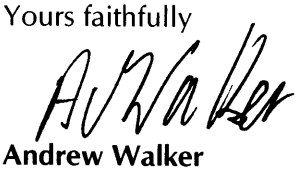
In considering the appropriate level of compensation, Ofgem recognises that there are advantages in not exposing Transco to undue risk. It may therefore be appropriate to consider capping Transco's liabilities and or allowing it to recover costs or any associated costs from compensatory payments.

Ofgem's decision

Accordingly, Ofgem has directed Transco not to implement this modification proposal, as it would not better facilitate the achievement of the relevant objectives as outlined in amended standard condition 9 of Transco's GT licence for the reasons outlined above.

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 faithfully



Andrew Walker
Director, Transmission Networks Regulation