

Modification Report
Increase the number of rounds in the Annual auctions for MSEC
Modification Reference Number 0651
Version 1.0

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

To increase the number of rounds over which the annual MSEC auction operate from 1 to 4

2. Transco's Opinion

Transco supports the implementation of this Modification Proposal. It does not consider that adjusting the number of auction rounds for Annual Monthly System Entry Capacity (AMSEC) will have a significant impact upon its own operations.

Transco believes that the proposer primarily wished to address the AMSEC auction scheduled to be held within February 2004 which will offer 100% of baseline entry capacity for the six months (April 04 to September 04), which is a result of this period having not previously been offered in any auction. It had previously been intended that the April 04 to September 04 period would be offered in an MSEC auction to be held in August 03 over 4 rounds. In the event Modification Proposal 0616 was implemented which changed the period offered in that August auction to a 6-month period (October 03 to March 04). Transco considers that this proposal is driven largely as a consequence of that change and agrees that a proposal to offer the period April 04 to September 04 over 4 rounds has merit.

Transco continues to be less convinced that a 4 round AMSEC auction will always be required because it is our expectation that the quantities on offer at major beach entry points will be much reduced as increasing quantities are taken up in Long Term System Entry Capacity (LTSEC) auctions. It is, however, also true that large quantities may continue to be offered in AMSEC auctions at storage sites where little long term demand has been in evidence, although low levels of demand suggest that the re-pricing opportunities offered by multiple rounds will largely be unnecessary.

Entry capacity auction IT systems are considered by Transco to have sufficient functionality flexibility to cater for further AMSEC auction rounds should the Proposal be implemented.

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

The Proposer does not state how implementation of the Proposal would better facilitate the relevant objectives. However, on the basis of the arguments presented in the responses to the Modification Proposal, Transco is of the view that it would better facilitate the relevant objectives by providing more information to the market and so better facilitate competition between shippers.

**4. The implications for Transco of implementing the Modification Proposal , including
a) implications for the operation of the System:**

Transco considers there to be no such implication.

b) development and capital cost and operating cost implications:

Transco considers there to be no capital costs associated with the Proposal and insignificant additional operating costs associated with the administration of additional rounds within the annual auction.

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 additional costs are expected.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Transco considers there to be no such consequence.

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 anticipates that implementation of the Modification Proposal would have no such consequence.

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

Transco retains computer system flexibility to operate single or multiple auction rounds and is unaware of any further implications related to computer systems.

7. The implications of implementing the Modification Proposal for Users

Any such implications are documented within the Summary of Representations.

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

Transco has not been made aware of any such implications.

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

No such consequences are envisaged.

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

Advantages:

- Increased information provision.
- Increases the potential for price discovery.

Disadvantage:

- AMSEC quantities offered in each round may be small.

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

Transco received a total of 12 responses to this Modification Proposal:

Powergen UK plc (POW)
Energeny-Koch Trading Europe ltd (EKT)
Scottish and Southern Energy plc (SSE)
Total Gas & Power ltd (TGP)
Hydro Energy (HE)
ConocoPhillips UK (CON)
ExxonMobil Gas Marketing (EXM)
British Gas Trading ltd (BGT)
Chevron UK ltd (CHE)
Statoil UK ltd (STA)
EDF Energy (EDF)
Shell Gas Direct (SGD)

All 12 respondents support implementation of the Proposal, including one (EXM) which offered support conditional on the 20% of baseline entry capacity continuing to be held back from long term entry capacity auctions.

Price Discovery and Market Information

Nine respondents (POW, SGD, EKT, SSE, TGP, EXM, BGT, STA, EDF) highlighted price discovery benefits where an increased number of rounds increases the information available to market participants in relation to the capacity volume requested and the value attributed to capacity through each auction round, such that Users may respond to such signals in subsequent rounds of the auction. It was noted by three respondents (CHE, STA, SGD) that improved price discovery could deliver further benefits in terms of a reduced likelihood of an over recovery of revenue by Transco and such that the stability of Transportation Charges is increased.

Transco Response

Transco agrees with respondents, and notes their preference, that the Proposed increase to 4 rounds within the AMSEC auction will release more information to the market in terms of the volume and price of capacity demanded by Users, and provide further opportunities for Users to respond to such signals. Transco notes comments regarding the impact of the Modification proposal, if implemented, on its recovery of allowed revenue and Transportation Charge stability, but considers that the reduced volumes of capacity being offered may lead to this effect being relatively minor.

Number of Auction Rounds on an Enduring Basis

Five respondents (POW, CHE, STA, SGD, SSE) made comment as to the benefits, described above, of holding AMSEC auctions in four rounds on an enduring basis. Four respondents (EKT, EXM, CON, SGD) noted that a future modification proposal could be considered should market participants consider that circumstances had changed, with two (EKT & EXM) suggesting a review where the 20% of capacity baseline held back from LTSEC was removed. It was stated by two respondents (TGP & HE) that 100% of baseline capacity should not be offered through auctions with only one round.

One respondent (EDF) stated that the Modification Proposal of 4 rounds should only be in place for the period April 04 to September 04 where 100% of baseline entry capacity was being released, this as originally intended prior to the implementation of Modification Proposal 0616.

Transco Response

Transco notes that prior to the implementation of Modification Proposal 0616, only the 20% of baseline capacity held back from LTSEC plus any unsold capacity would be offered through AMSEC auction processes of 1 round.

Transco considers that Users are best placed to comment on the merits of smaller quantities of capacity being offered within four auction rounds, and particularly where the bulk of the capacity for the ASEP period had been offered through an earlier LTSEC auction. Transco notes the view of respondents in this respect, but remains less convinced of the merits of a 4 round AMSEC auction process given the expectation of the smaller quantities of MSEC capacity being released.

Consequence of Retaining One Auction Round for AMSEC

It was noted by three respondents (HE, CHE, SGD) that the retention of one round for the AMSEC auction could tend to inflate prices where Users only have a single opportunity to purchase entry capacity. SGD stated that; "the results of the long term auctions demonstrated significant demand for entry capacity for some periods which will be covered by the upcoming AMSEC auctions. For some quarters, Transco needed to scale back demand. This may suggest that there will be demand for the 20% held back in these quarters. A single round auction holds the potential for inefficiently high prices to be achieved with the associated issues of over-recovery".

EKT noted that one round could introduce price signal distortions because of the artificial constraint this imposed. EXM commented that a single round could produce a wide range of prices with some capacity unsold. Both EKT and EXM expressed a view that competition issues could result where certain parties were disadvantaged, by example both suggested new entrants.

CHE suggested that a single auction round could potentially strand gas offshore where some shippers fail to capture the capacity they needed, which might impact gas flows into storage in the next year and also raise prices.

Transco Response

Transco is of the view that the smaller quantities of capacity that may be offered through AMSEC post September 04 will be as a result of shippers having had earlier opportunities to secure their entry capacity requirement, and that this in turn should act to ease price pressure in the AMSEC auction's.

Transco does not share the view that gas could potentially be stranded off-shore because of a single round AMSEC auction, given that the quantity of available capacity remains unchanged such that shippers only need to bid their value to demonstrate to whom a limited resource should be allocated. We also consider that daily capacity processes potentially present further opportunities for shippers to acquire entry capacity where this has not been previously allocated, or where interruptible capacity can be made available as indicated by shippers usage of previously allocated capacity.

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

No such requirement exists in respect of the Modification Proposal.

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

No such requirement exists in respect of the Modification Proposal.

14. Programme of works required as a consequence of implementing the Modification Proposal

Transco does not anticipate any system development as a consequence of implementing this Modification Proposal.

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

Final Modification Report issued - 20 November

Ofgem decision expected - late November

Effective date for implementation of Proposal - 1 December

16. Recommendation concerning the implementation of the Modification 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

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

SECTION B: SYSTEM USE AND CAPACITY

Amend paragraph 2.2.3 to read as follows:

“2.2.3 Transco’s annual invitation under paragraph 2.2.2 will specify:

(a) the dates (on which applications pursuant to the annual invitation may be made), which for the purposes of:

(i) paragraph 2.2.2(a), shall be four dates (each of which shall be a Business Day) on which applications pursuant to such annual invitation may be made; the period between each such date shall not be less than two Business Days; and

(ii) ...;

(each such date an “**annual**” invitation date);

(b) for each Aggregate System Entry Point, and in respect of each of Capacity Year +1 to Capacity Year +16 (inclusive), the Available System Entry Capacity (and, in respect of Capacity Year +1 and Capacity Year +2, the Available Monthly Capacity as referred to in paragraph (e) below) and the reserve price for Unsold System Entry Capacity (in accordance with the Transportation Statement) (the “**reserve price**”);

(c) ...;

(d) ...; and

(e) for each Aggregate System Entry Point and in respect of Capacity Year +1 and Capacity Year +2, the Available Monthly Capacity for the relevant calendar month on the relevant annual

invitation date. The “Available Monthly Capacity” for a calendar month shall mean, in respect of the first three annual invitation dates, an amount equal to 25% of the amount of the Available System Entry Capacity for that calendar month (as determined immediately prior to the first such annual invitation date); and in respect of the fourth annual invitation date shall mean an amount equal to the Available System Entry Capacity for that calendar month (again as determined immediately prior to the first such annual invitation date) less the amount of System Entry Capacity allocated in aggregate pursuant to the first three annual invitation dates for that calendar month.”

Amend paragraph 2.2.8(a) to read as follows:

“(a) in aggregate in respect of all annual invitation dates, up to but not more . . .”

Amend paragraph 2.2.9(b)(i) to read as follows:

“(i) where such bid is a monthly capacity bid, on the relevant invitation date;”

Amend paragraph 2.2.13(a) to read as follows:

(a) the aggregate System Entry Capacity Charges payable by the User were all the . . .”

Amend paragraph 2.2.13(b) to read as follows:

“(b) the User’s Relevant Code Indebtedness at 17:00 hours on any Business Day . . .”

Amend paragraph 2.7.2(a) to read as follows:

“(a) all capacity bids submitted in respect of the relevant short term period (excluding any bid rejected pursuant to paragraphs 2.2.11, 2.3.6, 2.4.6 or 2.5.6) will be ranked in order of bid price (the highest price ranking first) save that in

the case of monthly capacity bids made pursuant to paragraph 2.2.4 the ranking will be made in respect of each relevant annual invitation date;”

Amend paragraph 2.7.2(b)(i) to read as follows:

“(i) in the case of monthly capacity bids made pursuant to paragraph 2.2.4, the Available Monthly Capacity for the relevant annual invitation date for the calendar month;”

Amend paragraph 2.7.7 to read as follows:

“2.7.7 Transco will:

(a) in respect of Monthly System Entry Capacity allocated in respect of Capacity Year +1 not later than one month following the final date on which applications for Monthly System Entry Capacity could be made . . . ;

(b) in respect of Monthly System Entry Capacity allocated in respect of Capacity Year +2 not later than two months following the final date on which applications for Monthly System Entry Capacity could be made . . . ;

....”

Signed for and on behalf of Transco.

Signature:

Mike Calviou
Commercial Frameworks Manager
NT & T

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 **0651**, version **1.0** dated **20/11/2003**) 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 **1.0**.

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.