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Transco, Shippers and Other Interested  
Parties

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25 July 2002

Dear Colleague,

**Modification Proposal 0560 *'Publication of indicative maintenance schedule'***

AEP Energy Services Ltd raised Modification Proposal 0560 *'Publication of indicative maintenance schedule'* on 28 June 2002 and requested that it be granted urgent status. Ofgem granted the proposal urgent status on the same day and the proposal was issued for consultation.

Ofgem has carefully considered the issues raised in this proposal and has decided to accept it because we consider that this proposal will better facilitate the relevant objectives of Transco's Network Code.

In this letter, we explain the background to the modification proposal and give the reasons for making our decision.

**Background to the proposal**

*Auctions of entry capacity rights*

Transco has offered firm monthly system entry capacity (MSEC) rights on its National Transmission System (NTS) for sale via six-monthly auctions since September 1999.

In addition to offering MSEC, Transco also releases firm and interruptible capacity on a daily basis where there is additional physical capacity available.

In the event of a constraint at an entry point (when physical capacity is less than capacity sold against which gas is flowing) Transco can buy-back the capacity until the constraint is relieved. Transco has financial incentives in its Network Code to efficiently manage the costs of buying back capacity it has sold but cannot make physically available. This incentive is described in more detail below.

On 17 July 2002 Ofgem accepted Modification Proposal 0549, *'Summer 2002 Capacity Auction'*, which provides for the release of baseline levels of MSEC over four auction rounds, in which 25% of capacity is offered in each round, with any capacity unsold in rounds one to three offered in round four. In particular, Transco will be required to offer for sale 90 per cent of a series of baseline entry capacity output measures (the 'SO baseline volumes') that were proposed following Ofgem's review of Transco's price control and SO incentives for the period 2002–7. The baseline entry capacity outputs are set at the maximum physical capacity levels for each entry point. The SO baseline volumes of capacity were also made available in the February 2002 auctions and are published in Transco's Transportation Statement.

The next MSEC auctions are scheduled to occur in early August 2002 and, following Ofgem's acceptance of modification proposal 0564, *'Amendment to period of Summer Capacity Auctions to Six Months'*, will cover a six month period from October 2002 to March 2003.

#### *Transco's maintenance programme under the Network Code*

Transco is currently required, under Section L of the Network Code, to prepare and publish a maintenance programme outlining planned maintenance of the National Transmission System (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.

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.

The April and October programmes described above do not place an obligation on Transco or any other person to carry out any particular maintenance works or to do so at any particular time (other than Transco's requirement to undertake maintenance only during April to October), by virtue of the provisions contained in Section L of the Network Code. In particular, it is not intended to create an obligation to undertake the works listed in the programme. This is made clear in paragraph 3.2.5 of section L of the Network Code which states that, neither Transco nor any other person will be required, by virtue of anything contained in a Maintenance Programme, to carry out any particular maintenance works or (but without prejudice to paragraph 1.3.2 of Section L) to do so at any particular time. It is therefore clear that Transco has discretion to carry out maintenance works at any particular time but this is expressed to be without prejudice to paragraph 1.3.2 of

section L. This paragraph provides that a maintenance programme will not provide for maintenance of the NTS other than during the months of April to October inclusive in any year.

Transco's current April Maintenance Programme is published on its internet site ([www.transco.uk.com](http://www.transco.uk.com)) and contains details relating to the period 1 April 2002 to 30 September 2002. It does not contain details for the period commencing 1 October 2002.

#### *Auctions and the publication of maintenance information*

Ofgem notes that on 31 January 2002 it rejected Transco's modification proposal 0522, '*Deferral of Maintenance Information Publication Obligation*'. This modification proposal sought to defer Transco's Network Code obligation to publish information relating to its April Maintenance Programme. Under the proposal, the publication of the draft Maintenance Programme for this period was to be deferred until following the MSEC auctions for the period 1 April 2002 to 30 September 2002.

Ofgem rejected the proposal on the basis that the publication of the draft NTS maintenance information would assist shippers in efficiently valuing capacity in the monthly auctions and as such, Ofgem concluded that the proposal would not better facilitate the relevant objectives of the Network Code.

#### *Transco's System Operator incentives*

Ofgem published its final proposals for Transco's NTS System Operator (SO) incentives for 2002–7 in December 2001<sup>1</sup> and published licence modifications for statutory consultation under section 23 of the Gas Act 1986 in April 2002 together with an explanatory note on 12 April 2002.<sup>2</sup> These proposed modifications seek to introduce into Transco's Gas Transporter (GT) licence, with effect from 1 April 2002, new price controls and SO incentives for Transco, including a buy-back incentive. Ofgem is currently considering the responses that it has received to this consultation. The views expressed in this letter do not in anyway fetter the

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<sup>1</sup> '*Transco's National Transmission System Operator Incentives – Final proposals*', Ofgem, December 2001.

<sup>2</sup> '*Transco price control and NTS SO incentives 2002–7, 'Explanatory Notes to accompany the section 23 notice of proposed licence modifications to Transco's gas transporter licence*', Ofgem, April 2002.

discretion of the Authority with respect to the proposed licence modifications referred to above.

Under these proposals, Transco will be required to offer for sale baseline capacity volumes in the form of firm, tradable entry capacity rights through a series of long and shorter-term auctions. Transco will be able to earn incentive revenue from investing above its baseline capacity measures, in response to signals emerging from long-term auctions. The proposals also provide for a number of day-to-day incentives on Transco to efficiently manage the operation of the NTS.

Following Ofgem's acceptance of Modification Proposal 0540, '*Delay of Licence and Effects on Capacity Incentives*' on 28 March 2002, new parameters were introduced to Transco's existing Network Code based buy-back incentive with effect from 1 April 2002 to 31 March 2002. Under this modification, Transco has incentives to efficiently manage the costs of buying back capacity it has sold but cannot make physically available. Transco may need to buy-back capacity as a result of its maintenance programme, seasonal or plant reliability reasons. Transco faces a £35 million target level of net buy-back costs and is rewarded for performance below target and penalised for performance above target. Transco's possible revenues and costs under this incentive are subject to a cap of £30 million and a collar of £12.5 million.

On 9 April 2002, Ofgem accepted Modification Proposal 0498, '*Capacity forward and option entry capacity management*', which gave Transco increased freedom to use a wider range of tools such as forwards and options contracts for the purposes of entry capacity management. The use of such tools is designed to allow Transco the opportunity to seek to minimise its exposure to buy-back costs.

#### *Information disclosure*

As part of its published licence modifications for statutory consultation under section 23 of the Gas Act 1986 issued on 12 April 2002 (referred to above), Ofgem has proposed licence amendments to require Transco to comply with Network Code obligations to release commercial and operational information relating to the operation of Transco's pipeline system. Ofgem believes that the disclosure of information in relation to the operation of the NTS should increase the efficiency of the wholesale market and help to address existing asymmetries in access to operational and commercial information.

## **The proposal**

This modification proposal provides for the Network Code to be amended to oblige Transco to publish each year an annual maintenance programme at least one week ahead of the annual NTS entry capacity auctions. The indicative annual maintenance reports should be based on the current April and October maintenance programme reports but would cover the period October to September for the forthcoming year. The report would set out the impact of any planned maintenance on entry capacity availability at all system entry points.

## **Respondents' views**

The majority of the twelve respondents who commented on this proposal supported it, with some respondents qualifying their support.

The majority of respondents were of the view that publication of Transco's annual maintenance programme ahead of the annual entry capacity auctions would allow shippers to inform their bidding strategies and better value the entry capacity rights being offered for sale in formulating their bidding strategies.

One respondent supporting the proposal stated that the fact that currently there is limited information available about Transco's maintenance programme had led to this respondent supporting a six-month auction for the forthcoming entry capacity auction. One respondent said that a failure to make this information available would lead to inefficient bidding behaviour and increased costs.

Another respondent however questioned the need for this proposal if the auctions only cover six months as proposed under Modification Proposal 0564. This respondent added that it should not replace obligations on Transco to publish maintenance schedules at other times of the year.

One respondent argued that the proposal if implemented will improve the liquidity of the secondary capacity market by providing shippers with more confidence to offer Transco capacity through its forward and option tenders. This respondent also argued that the proposal would help market participants to monitor Transco's performance and that increased information flows are essential as the industry moves toward a long-term entry capacity regime.

However, a number of respondents qualified their support in respect of the timing of the release of Transco's maintenance programme. These respondents considered that one week prior to the auctions was not sufficient time to enable shippers to take the information into account in formulating their bidding strategies. Two of these respondents suggested a minimum period of two weeks in advance of the auctions.

One of these respondents also questioned how accurate any maintenance plans produced in July 2002 could be for the following summer and made the point that the information was not audited. It suggested alternative timing, in which annual capacity auctions are held in spring, when Transco has up to date data on maintenance for the following summer. It recommended a six-month auction covering October 2002 to March 2003 and then annual auctions in spring 2003 for the capacity period April 2003 to March 2004.

Two respondents did not support the proposal. One of these respondents expressed doubts as to the benefits that would accrue from the publication of an 'indicative' maintenance schedule and considered it necessary for the industry to gain experience with Transco's new incentives and tools before introducing more prescriptive obligations. The other respondent considered that it is inappropriate for Transco to publish its maintenance plans ahead of the auctions. Instead it indicated that Transco should take decisions regarding its maintenance planning in light of the signals it receives from the capacity auctions.

### **Transco's view**

Transco does not support implementation of this proposal.

Transco argues that its release of maintenance information should be part of a wider debate about the range of information that should be released by all parties to enable efficient operation of the market. In particular, Transco cited offshore and downstream maintenance information as examples of other types of information which should be considered for release.

Transco believes that the intent of the incentive arrangements proposed by Ofgem is to encourage Transco to adopt a flexible approach to scheduling maintenance in light of market signals about the valuation of capacity over different periods.

Transco is concerned that the publication of indicative maintenance plans before the entry capacity auctions would have limited value and may potentially be misleading because Transco may significantly alter its maintenance plans following an auction.

Transco also states that it does not have a well-developed maintenance plan at this time. As such it states that the information does not currently exist. It therefore argues that there would be large uncertainties about a maintenance plan published under this proposal.

Transco argues that the fact that maintenance plans published under this proposal would be uncertain could distort the capacity market by providing information that was later substantially changed.

Transco expresses a further concern that the proposal could require it to publish commercially sensitive information regarding its future maintenance plans at a time when Transco is negotiating with potential contractors regarding the provision of maintenance services. Transco argues that this could commercially disadvantage it, which would result in increased costs for Transco and users.

Transco also challenged the view put forward by respondents that Transco's maintenance programme should affect the value placed on capacity by users. It argues that purchasers of firm capacity have rights to nominate gas flows up to the quantities of firm capacity that they have purchased and this will not be affected by maintenance. It questioned why actual physical capabilities should affect users' valuations of capacity. Rather, Transco believes that this information is most likely to be used to gauge Transco's potential distress in the entry capacity buy-back market. Transco does not believe that the provision of its maintenance plans under this proposal would be economic or efficient and could be less efficient if it leads to increased capacity management and maintenance costs.

### **Ofgem's view**

Ofgem considers that the proposal for Transco to publish an indicative maintenance programme at least one week ahead of the entry capacity auctions commencing on 1 October in any year and relating to maintenance over the 12 period commencing on 1 October of that same year will enable bidders to have access to maintenance information that will assist them in efficiently valuing capacity in the capacity auctions.



As we noted in our decision on modification proposal 0522, Ofgem considers that the publication of indicative maintenance information should assist shippers in determining the level of capacity that Transco can make physically available across the NTS which will in turn impact upon the value that shippers attach to the capacity rights offered in the MSEC auctions.

By assisting shippers in efficiently valuing capacity the proposal should better facilitate the relevant objectives by securing effective competition between relevant shippers and relevant suppliers. In this context, to the extent that the value of capacity is influenced by maintenance during particular periods, shippers may be able to efficiently adjust their gas flow and capacity requirements to periods where, for example, maintenance is not occurring, thereby minimising the costs of their capacity purchases.

Ofgem also considers that the proposal should better facilitate the economic and efficient operation of Transco's pipeline system by providing Transco with information on the value that shippers place on capacity during periods of maintenance. This should assist Transco in efficiently determining whether to adjust its maintenance programme to minimise the costs associated with capacity buy-backs. Under this proposal and the current provisions of the Network Code, Transco has the ability and discretion to adjust its maintenance programme on the basis of the valuations of capacity established through the auctions and any capacity buy-back tenders it undertakes and in response to its capacity buy-back incentive.

Ofgem does not accept that implementation of the proposal would place Transco in the situation of a distressed purchaser, thereby potentially leading to increased capacity management and maintenance costs. As outlined above, Ofgem considers that Transco should be able to respond to signals emerging from the auctions and secondary markets about the valuation of capacity over different periods in determining its maintenance scheduling. Further, Transco also has the ability to minimise its risks in buying back capacity by conducting forward tenders.

Ofgem would note that the Network Code already provides for the release of an October maintenance programme in draft form by 1 September each year. This programme would include provisional maintenance for the summer period of the following year. However, this information would not be provided to shippers in sufficient time for any MSEC auctions that occurred before 1 September. As such,

even though some maintenance information would be available to secondary capacity markets in draft form by 1 September in any year, Ofgem considers that it is nevertheless important that an indicative maintenance programme is published before the MSEC auctions.

Ofgem also notes that under the existing provisions of the Network Code Transco should receive updated information from shippers by 30 June each year on which to base its October maintenance programme for the two-year period commencing 1 October. As such, Ofgem questions Transco's assertions that information does not or would not exist on which to publish an indicative programme prior to 1 September in any year.

### **Ofgem's decision**

For the reasons outlined above Ofgem has decided to direct Transco to implement this modification proposal because we consider that it better facilitates the achievement of the relevant objectives as outlined under Amended Standard Condition 9 of Transco's GT licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number or Lynette Camilleri on extension 7431.

Yours sincerely,

Mark Feather  
**Head of New Gas Trading Arrangements**