

URGENT Modification Report
MSEC Auction Quantity Revision and Capacity Incentive Adjustment
Modification Reference Number 0483

Version 1.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because any changes to the structure of the NTS Entry Capacity auction regime will need to be made in a timely manner prior to 13 August 2001, the scheduled commencement date of the auctions for Entry Capacity over the period 1 October 2001 and 31 March 2002. Provision of Urgent status should allow Transco time to issue an amendment to its invitation to the auction and provide time for shippers to amend their bidding strategies if the proposal is accepted.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Issued to Ofgem for decision on Urgency	31 July 2001
Proposal agreed as Urgent	31 July 2001
Proposal issued for consultation	01 August 2001
Close out for representations	07 August 2001
Final report to Ofgem	09 August 2001
Ofgem decision expected	10 August 2001

1. The Modification Proposal

This proposal has three interlinked elements:

- a) Transco proposes that the Determined System Entry Capacity should continue to be equal to SND+10% but that the quantities offered in each auction round under the present arrangements are revised.
- b) Transco proposes to apply a revised process to determine the quantities of capacity to be made available in the fifth round.
- c) It is also proposed that the capacity incentive arrangements will be adjusted to reflect the reduced potential for incremental sales of Daily System Entry Capacity at the most highly valued ASEPs should the increased customer flexibility offered in round five generate higher capacity sales at such ASEPs.

In respect of the quantities of entry capacity, the modification would provide an assurance that larger quantities would be available in the 5th round of the MSEC

auctions. It is proposed that 90% of the Determined System Entry Capacity is offered in equal sized tranches for rounds 1 to 4 of the MSEC auctions.

The residual quantity, offered in round 5, would therefore comprise a minimum aggregate quantity equivalent to 10% of Determined System Entry Capacity for all Aggregate System Entry Point (ASEPs) plus any quantities remaining unsold from the preceding auction rounds. Such quantities would then be available for bid acceptance in price order subject to limitations specified in this proposal.

The second element of the proposal would enable Transco to increase capacity availability at individual ASEPs by taking into account both individual ASEP limits and where appropriate group limits that may be applicable. The use of a group limit alongside individual maxima will be applied in the fifth auction round.

Transco envisages such an approach would apply initially only to the St Fergus, Barrow and Teesside combination of ASEPs for the period October 2001 – March 2002 and seeks respondents views on the appropriateness of such a position.

Transco envisages that implementation of this approach to fifth round quantities may increase the quantities sold in the auction at one or more terminals within the proposed St Fergus, Barrow and Teesside combination. Therefore the proposal also includes an amendment to the capacity incentive and neutrality mechanism to reflect the likely change in risk/reward arising from such change. This adjustment is designed to reflect the reduced likelihood of incremental revenue flowing into the capacity incentive and neutrality mechanism at terminals where increased levels of MSEC sales result from this proposal.

Transco proposes to specify the maximum individual ASEP availability and an aggregate limit for the total quantity to be made available at the defined combinations of ASEPs. The fifth round will then enable bids to be accepted in descending price order but subject to both the maximum individual ASEP availability and the maximum aggregate ASEP availability of the defined combination (where appropriate).

If approved, Transco proposes to publish the revised maximum individual and aggregate ASEP availabilities via an amendment to the Transportation Statement. In addition a revised invitation to participate in the auction will be published.

Should this approach be implemented Transco would declare the following availabilities in the Transportation Statement:

Max availability in round 5 GWh	Oct 2001	Nov 2001	Dec 2001	Jan 2002	Feb 2002	Mar 2002
St Fergus	1391	1447	1459	1493	1476	1481
Barrow	481	596	637	637	627	606
Teesside	448	493	538	549	538	504
Northern Triangle	2011	2273	2426	2472	2450	2351
absolute max						

This approach would facilitate the potential sale of higher levels of individual ASEP capacity than would have been the case at terminals within the defined St Fergus, Barrow and Teesside combination. Whilst the aggregate sales in this combination are limited to the same aggregate level defined within the present invitation to participate in the auctions, it should facilitate greater shipper choice via the revised fifth round approach. That additional choice for shippers has a consequence of potentially reducing incremental revenue flows into the capacity incentive and neutrality mechanism. Additionally the approach may increase the risk of buy-back. The effects of such a change will therefore impact the likely capacity incentive and neutrality mechanism. Hence it is appropriate to consider an amendment to the incentive.

The proposal may have a significant effect on the potential to generate incremental revenue into the incentive mechanism. Specifically increased MSEC sales at a particular ASEP might be expected to reduce the potential for day ahead and within day sales. An approximate impact might be assessed from the outcome of the MSEC auctions and an appropriate adjustment made in the incentive.

The capacity incentive and neutrality mechanism could therefore be adjusted as follows:

Where actual allocation in the MSEC auctions at an individual ASEP (St Fergus, Barrow or Teesside) exceeds the maximum allocation that is possible when applying the proposed group limit on a pro-rata basis, then a monthly compensatory sum will be made available to Transco in the capacity incentive (i.e. pro-rata quantities equal the maximum capacity availability at each of St. Fergus, Barrow and Teesside as specified in the present "invitation to auction"). That amount shall be equal to the applicable Daily System Entry Capacity (DSEC) reserve price, as published in the relevant charging statement, multiplied by the incremental quantity identified above for the relevant month, multiplied by 20%. It is proposed that the monthly sum be drawn from the balance of monies received for the sale of Daily Capacity. If actual allocation at an ASEP does not exceed the pro-rata allocation then no contribution is required. Where the monthly sum is less than the aggregate amount of relevant

capacity incentive revenue, which Transco would normally have re-distributed to the holders of MSEC at each ASEP (80% of incentive revenue), Transco will deduct the monthly sum from the relevant capacity incentive revenue and re-distribute the remaining amount to the holders of MSEC at each ASEP in proportion to the revenue received for Daily Capacity services at each ASEP. Should the sum not be available in its entirety in the required month then the residual sum will be rolled over to the following month.

At the end of the six-month period, if Transco has been unable to collect the sum of the monthly sums, an “ad hoc” invoice will be issued to capacity holders to facilitate the collection of outstanding amounts. This invoice will be targeted to holders of MSEC in proportion to the level of revenue for daily capacity services at each ASEP over the period in question.

2. Transco’s Opinion

Transco supports implementation of this proposal at the earliest opportunity

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

It is recognised that a number of Modification Proposals have recently been raised relating to the entry capacity auction regime. This Modification Proposal, if implemented, is expected to enable greater opportunity for shippers to secure entry capacity at the places where shippers value it most highly thus promoting shipper-to-shipper competition. This could be considered to improve the efficiency of the auctions and, in turn, further the economic and efficient use of the pipeline system and promote effective competition between Users.

4. The implications for Transco of implementing the Modification Proposal , including

a) implications for the operation of the System:

No implications are envisaged for the operation of the System.

b) development and capital cost and operating cost implications:

No additional development and capital costs are envisaged.

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:

Transco does not anticipate that implementation of this Modification Proposal would create significant additional costs which it would seek to recover.

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

None

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

It is not envisaged that implementation of this Modification Proposal would significantly increase the level of contractual risk to Transco under the Network Code.

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

This change could be accommodated by the existing computer systems and no development work would be required.

Transco is unaware of any implications for the computer systems of Users.

7. The implications of implementing the Modification Proposal for Users

In respect of the quantities of entry capacity, the modification would provide an assurance that larger quantities would be available in the 5th round of the MSEC auctions. It is proposed that 90% of the Determined System Entry Capacity is offered in equal sized tranches for rounds 1 to 4 of the MSEC auctions.

The residual quantity, offered in round 5, would therefore comprise a minimum aggregate quantity equivalent to 10% of Determined System Entry Capacity for all Aggregate System Entry Point (ASEPs) plus any quantities remaining unsold from the preceding auction rounds. Such quantities would then be available for bid acceptance in price order subject to limitations specified in this proposal.

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

Transco does not envisage any implications of implementing the Modification Proposal for the above parties.

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 consequences are envisaged on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party as a result of implementing the Modification Proposal.

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

Advantages:

Greater flexibility to allocate capacity in round five.
The possibility of offering increased quantities at any of the three northern Terminals above that which is currently allocated.
The auctions would be marginally less reliant on historic profiles of capacity quantities at each ASEP.

Disadvantages:

The perception that lower quantities being offered in the early rounds could cause price escalation.

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

Representations have been received from the following parties :

Conoco UK Limited (Conoco)
Powergen
Chevron UK Limited (Chevron)
BG Group (BG)
Shell Gas Direct Limited (SGD)
ExxonMobil Gas Marketing (ExxonMobil)
Scottish and Southern Energy (SSE)
BP Gas Marketing Limited (BP)
TXU Europe Energy Trading Limited (TXU)
British Gas Trading (BGT)
TotalFinaElf Gas and Power Limited (TFEG&P)
TotalFinaElf Exploration UK PLC (TFE)
Alliance Gas Limited (AGL)
Enron

None of the respondents support implementation of this proposal, although Powergen "supports the flexible allocation of MSEC capacity advocated by this proposal but do not believe the associated adjustment to the capacity incentive is required", and Chevron and SGD support the concept of enabling bidders to gain entry capacity where they value it most highly. However both Powergen and SGD are against the late timing of the proposal, a view that is shared by SSE.

All respondents apart from Powergen consider that decreasing the volumes auctioned in the first four rounds will only serve to escalate bid prices and make an over-recovery more likely, with any potential benefit of the increased total capacity being far outweighed by the increased risk of higher prices caused by the imposed artificial constraint in the early rounds.

Conoco, BGT and Enron also doubt whether the proposal will result in significant additional capacity being allocated at St Fergus

Powergen, Conoco, BG, SSE, SGD, BGT and Chevron are also against any associated change to the capacity incentive scheme, with Powergen, Conoco and Chevron of the view that Transco should accept the existing scheme as it stands, whilst SGD do not believe that sufficient analysis has been given to warrant the change. BG, SSE and BGT consider that "any change should be part of a thorough re-assessment" and after "affording time for a considered debate."

TFEG&P, Enron and TFE are also seriously concerned over the redistribution of any over-recovery and the potential for cross subsidy, TFE stating it is discriminatory.

Transco Response

Transco recognises and appreciates the concerns raised. However, it remains Transco's view that any change should consider all parameters, including the incentive scheme. Transco continues to believe that increasing the degree of competition for capacity furthers the relevant objectives set out in its PGT Licence.

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

Implementation is not required to enable Transco to facilitate compliance with safety or other legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) or the statement furnished by Transco under Standard Condition 3(1) of the Licence

Implementation is not required as a consequence of any proposed change in the methodology established under Standard Condition 3(5) of the statement furnished by Transco under Standard Condition 3(1) of the Licence.

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

No modifications are required to the UK-Link Systems and therefore a programme of works would not be required as a result of implementing the Modification Proposal.

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

Transco proposes that this Modification Proposal is implemented on 10th August 2001

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends that this Modification Proposal is implemented.

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

TRANSITIONAL DOCUMENT, PART II

Add new paragraph 8.1.3A to read as follows:

"8.1.3 B2.3 In respect of the [calendar months October 2001 to March 2002 (inclusive)]:

- (1) for the purposes of Section B2.3.2(b)(i), the invitation for each of the first four invitation dates shall specify an amount of Monthly System Entry Capacity equal to 90 [per cent] [%] of the Determined System Entry Capacity;
- (2) for the purposes of Section B2.3.2(b)(ii), the invitation for the fifth invitation date shall specify an amount of Monthly System Entry Capacity equal to the sum of:

- (a) for all Aggregate System Entry Points the amount by which the amount of Determined System Entry Capacity made available on the first four invitation dates exceeds, after allocation of System Entry Capacity following applications made on such dates in respect of all Aggregate System Entry Points, the amount of Monthly System Entry Capacity held for the time being by Users (if any);

and

- (b) 10 [per cent] [%] of Determined System Entry Capacity for each Aggregate System Point,

("Maximum Aggregate 2001/2002 Entry Capacity");

- (3) Users may apply for Monthly System Entry Capacity in respect of an Aggregate System Entry Point for a calendar month in the Gas Year on the fifth invitation date;

- (4) for the purposes of the allocation of Monthly System Entry Section Capacity on the fifth invitation date Section B2.3.7(b) shall apply provided that Monthly System Entry Capacity will be allocated

- (a) without prejudice to paragraphs (b) and (c), in respect of an Aggregate System Entry Point, until (taking into account the amount of Monthly System Entry Capacity for the time being held by Users in aggregate) the amount of Monthly System Entry Capacity, in aggregate for which bids are accepted, equals (or falls short by no more than the minimum eligible amount) an amount of System Entry Capacity equal to the Maximum System Entry Capacity [(for which purposes in respect of a Relevant 2001/2002 ASEP such amount shall be the amount set out in the invitation referred to in Section B2.3.2(b)(ii) **("Maximum 2001/2002 Relevant ASEP Entry Capacity")**];

- (b) [without prejudice to paragraph (c), until in respect of all 2001/2002 Relevant ASEPS's, the amount of Monthly System Entry Capacity in aggregate for which bids are accepted equals (or falls short by no

more than the minimum eligible amount) an amount of System Entry Capacity equal to the Maximum Aggregate 2001/2002 Relevant ASEP Entry Capacity]; and

- (c) [in respect of all Aggregate System Entry Points, until the amount of Monthly System Entry Capacity in aggregate for which bids are accepted equals (or falls short by no more than the minimum eligible amount an amount of System Entry Capacity equal to the [Maximum Aggregate 2001/2002 Entry Capacity];
- (5) for the purposes of Section 2.3.7(a)(iii), the reference to Available Monthly Capacity will be treated for the purposes of:
 - (a) paragraph (4)(a), as a reference to, without prejudice thereto, Maximum System Entry Capacity;
 - (b) paragraph (4)(b), as a reference to Maximum Aggregate 2001/2002 Relevant ASEP Entry Capacity; and
 - (c) paragraph (4)(c), as a reference to Maximum Aggregate 2001/2002 Entry Capacity; and
- (6) for the purposes of paragraphs (2), (3), (4) and (5) and paragraph 8.1.11 of this Part II:
 - (a) the Aggregate System Entry Point at each of Barrow, St Fergus and Teesside are " **2001/2000 Relevant ASEP's**"; and
 - (b) "**Maximum Aggregate 2001/2002 Relevant ASEP Entry Capacity**" is the sum of the Maximum 2001/2002 Relevant ASEP Entry Capacity for each 2001/2002 Relevant ASEP.

Add new paragraph 8.1.11 to read as follows:

"8.1.11 B2.13 For the purposes of each of the calendars months October 2001 to March 2002 (inclusive):

- (1) the Incentive Relevant Capacity Amount shall be determined as:

$$(ARCC - ACIC) - (ARCR - ACIR + ATMA)$$

where ARCC, ACIC, ARCR and ACIR have the meanings in Section B2.13.3 and ATMA is the [sum of the] Transco Monthly Amount for each 2001/2002 Relevant ASEP [**"Aggregate Transco Monthly Amount"**];

- (2) the "**Transco Monthly Amount**" is , in respect of a 2001/2002 Relevant ASEP:

$$RCA * RRP$$

where:

(a) RCA is the amount by which the Monthly System Entry Capacity held by Users for the time being exceeds the Notional Maximum System Entry Capacity;

(b) RRP is the [applicable reserve price (for the 2001/2002 Relevant ASEP) set out in the Transportation Statement],
and where the "**Notional Maximum System Entry Capacity**" is, in respect of a 2001/2002 Relevant ASEP, [that amount of System Entry Capacity which when aggregated with the Notional Maximum System Entry Capacity for each other 2001/2002 Relevant ASEP equals, in the same proportions as the Maximum 2001/2002 Relevant ASEP Entry Capacity for each 2001/2002 Relevant ASEP bear to each other, the Maximum Aggregate 2001/2002 Relevant ASEP Entry Capacity];

(3) for the purposes of Section 2.13.5(a)(i) and (ii) and the calculations therein in respect of a 2001/2002 Relevant ASEP, CIR shall be replaced by RARA, where RARA is the 2001/2002 Relevant ASEP Capacity Recovery Amount;

(4) in respect of a 2001/2002 Relevant ASEP:

(a) "**2001/2002 Relevant ASEP Capacity Recovery Amount**" is:

$$RCRA * CIR / ACIR$$

where CIR has the meaning in Section B2.13.5 and:

(i) RCRA is the Capacity Recovery Amount; and

(ii) ACIR are the [2001/2002 Relevant ASEP] Aggregate Capacity Incentive Revenues;

(b) "**Capacity Recovery Amount**" is the amount (if any) by which [2001/2002 Relevant ASEP] Aggregate Capacity Incentive Amounts exceeds the Aggregate Transco Monthly Amount;

(c) "**Capacity Under-recovery Amount**" is the amount (if any) by which the Aggregate Transco Monthly Amount exceeds the [2001/2002 Relevant ASEP] Aggregate Capacity Incentive Revenues; and

(d) "**[2001/2002 Relevant ASEP] Aggregate Capacity Incentive Revenues**" is the sum of the Capacity Incentive Revenues for all [2001/2002 Relevant ASEP's] [Aggregate System Entry Points];

(5) for which there is a Capacity Under-Recovery Amount, each relevant User shall pay Transco, in respect of each [2001/2002 Relevant ASEP] [Aggregate System Entry Point] at which the User held Registered Capacity for the calendar month, an amount ("**2001/2002 Relevant ASEP Under-recovery Charge**") determined as:

$$\text{CURA} * \text{RURC} / \text{RARC}$$

where

CURA is the 2001/2002 Relevant ASEP Capacity Under-recovery Amount;

RURC is the User's Registered Monthly System Entry Capacity at the [2001/2002 Relevant ASEP] [Aggregate System Entry Point];
and

RARC is the aggregate of all User's Registered Monthly System Entry Capacity at the [2001/2002 Relevant ASEP] [Aggregate System Entry Point];

(6) **"2001/2002 Relevant ASEP Capacity Under-recovery Amount"** is, in respect of a 2001/2002 Relevant ASEP:

$$\text{URA} * \text{CIR} / \text{ACIR}$$

where CIR and has the meanings in paragraph 2.13.5 and:

(i) URA is the Capacity Under-recovery Amount; and

(ii) ACIR are the [2001/2002 Relevant ASEP] Aggregate Capacity Incentive Revenues;

(7) 2001/2002 Relevant ASEP Under-recovery Charges shall be invoiced and payable in accordance with Section S; and

(8) Transco will not later than [] April 2002 submit (as an Ad-hoc Invoice) an Invoice Document in relation to [any of] the calendar months October 2001 to March 2002 (inclusive) in respect of amounts payable under paragraph (6)."

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0483**, version **1.0** dated **09/08/2001**) 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.