



The Joint Office, Relevant Gas
Transporters and other interested
parties

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18 August 2005

Dear Colleague

Uniform Network Code modification proposal 0030 "Extension of the QSEC auction timetable for 2005"

Ofgem¹ has considered the issues raised in the modification report in respect of modification proposal 0030 "Extension of the QSEC auction timetable for 2005" and, having regard to the principal objective and statutory duties of the Authority², has decided to direct the relevant gas transporters to implement modification proposal 0030.

The reasons for this decision are set out below.

Background to the proposal

The modifications introduced into Transco's gas transporter (GT) licence in September 2002 (effective April 2002) introduced the separation of the regulation of Transco's role as Transmission asset owner (TO), where it builds and maintains the network, from its role as National Transmission System (NTS) system operator (SO) where it operates the system on a day-to-day basis and determines the need for additional capacity.

In respect of NTS entry capacity, Transco NTS is funded under its TO function to provide specified TO baseline output measures of entry capacity at each existing entry terminal to its NTS. Under its NTS GT licence, Transco must offer for sale SO baseline output measures, which it does through a series of long-term and shorter-term entry capacity auctions. The SO baseline output measures are set at 90 per cent of the TO baseline output measures at each specified terminal.

¹ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably in this letter.

² Set out in Section 4AA of the Gas Act 1986, as amended.

Long-term entry capacity auctions

Following Ofgem's approval of modification 0500 to Transco's Network Code, 'Long Term Capacity Allocation', Transco NTS makes available the SO output measures through auctions of quarterly system entry capacity (QSEC) rights to access the NTS up to 15 years ahead of use. The first long-term auction for the sale of QSEC from 2004 to 2017 was held in January 2003, with subsequent auctions occurring in September 2003 and September 2004 for the periods between April 2005 to March 2020 and April 2006 to March 2021 respectively. In addition, an auction was held in February 2004 for QSEC capacity at two new entry terminals (Garton and Barton Stacey), and an extended auction was held in December 2004 for capacity at Milford Haven. Under the current arrangements, the next long term auctions are scheduled to occur between 1 September and 30 September 2005 for the sale of QSEC rights from April 2007 to March 2022.

Ofgem's consultation on Unit Cost Allowances

On 25 May 2005, Ofgem published a document³ which sought views on the level of Unit Cost Allowances (UCAs)⁴ at some potential new entry terminals.⁵ In addition, this document consulted on the potential resetting of all existing UCAs before the next round of long-term auctions. In particular, the document sought views on the advantages and disadvantages of:

- resetting UCAs for all entry points and delaying the LTSEC auctions presently scheduled for September 2005;
- retaining the current UCAs for all entry points and setting UCAs on new entry points on the basis of benchmark comparisons with existing UCAs;
- any other approach to resetting UCAs that respondents might favour.

On 17 August 2005 Ofgem published a document⁶ outlining its conclusions on this issue. In summary, after carefully considering respondents' views, its principal objective and statutory duties, Ofgem proposed that UCAs for existing terminals are retained at their current level until the end of this price control. In addition, Ofgem proposed that UCAs on smaller new entry points are capped in relation to UCAs at nearby existing entry points. Further consultation will be undertaken in relation to the treatment of large new entry points.

The Modification Proposal

Against the background set out above, Transco NTS submitted non-urgent modification proposal 0030 on 24 June 2005.

³ *Gas Transmission – new entry points, reserve prices in auctions and unit cost allowances*, Ofgem, May 2005.

⁴ UCAs are estimates of the unit cost of providing long-run incremental capacity at an entry point on the NTS.

⁵ A number of developers interested in establishing new gas storage sites that would require connections to the NTS have requested that Ofgem set a number of UCAs for these proposed entry points to the NTS (and one proposed entry point to a DN).

⁶ *Section 23 Notice to modify Transco's Gas Transporter Licence – Explanatory note to accompany proposals for new entry points to Transco's National Transmission System*, Ofgem, August 2005.

In summary, this modification proposal extends the relevant period for undertaking the 2005 QSEC auction from 1 September 2005 – 30 September 2005 to 1 September – 30 November 2005, potentially allowing a delay in the commencement of the long term entry capacity auctions.

The purpose of this proposal was to provide for additional flexibility in the auction timetable in the light of Ofgem's consultation on the setting of UCAs. In particular, the proposal sought to cater for the following possibilities:

- Ofgem's final proposals on UCAs were not available by 19th August 2005; and/or
- Ofgem's final proposals require further industry consultations to establish new auction prices for System Entry Points; and/or
- any other related circumstances that would affect auction prices

without impacting the timescales for undertaking the annual and rolling monthly NTS entry capacity auctions that follow the QSEC auctions.

Respondents' views⁷

Nine responses were received in relation to modification proposal 0030. Of these, six respondents, as well as the proposer, expressed support for the proposal and one stated that it was not in favour of implementation of the modification. Two respondents offered qualified support for the proposal.

Respondents who were in favour of this modification proposal generally offered their support to the proposal in light of the Ofgem consultation on UCAs, although some respondents expressed concerns regarding the merits of this consultation. The respondent who was against this proposal noted that it did not offer its support on the basis that it did not support adjusting current UCAs for the existing entry points during the current price control period.

The respondents' views are set out in more detail in the section below.

Respondents supporting the proposal

The proposer stated that the proposed change to the 2005 QSEC auction timetable is required if there is no clarity on entry UCAs for existing System Entry Points before the auction invitation is required to be issued on 19th August 2005. The proposer stated that although, if implemented, the modification proposal would introduce additional uncertainty in the precise timing of the 2005 QSEC auction, it considered that this would be preferable to running the auction according to prevailing UNC timescales in the knowledge of a potential change to the UCAs. The proposer believed that, while this additional uncertainty is unavoidable, it can be minimised by considering those factors that might influence the timings of the QSEC auctions if these were to be held beyond September. In particular, the proposer noted that further information in respect of the release of the Gemini system had come to light that provided clarity on the availability of Gemini later in 2005

⁷ This section is intended to summarise the principal themes of the respondents' views and is not intended to provide a comprehensive overview of the responses received. These can be found on the Gas Transporters information service (formally known as Nemisys)) <https://gtis.gasgovernance.com>

and explained that it would be unrealistic to hold the QSEC auction in the first half of October 2005.

One respondent noted that, given the timescales and the need to consider any decision Ofgem makes on UCAs, they considered it prudent to ensure that the auctions be delayed to allow for the invitation to be issued at least 28 days prior to the auctions themselves. The respondent, however, noted that, while they supported this proposal, it should not be assumed that they accept the use of long term auctions as an adequate or reliable approach to network investment decisions.

Another respondent noted that until Ofgem's UCA consultation has concluded and there is greater certainty of the arrangements, it would be impractical to conduct the long term auction process in accordance with the timetable as detailed within the UNC.

A respondent stated that they agreed with the view put forward in the Draft Modification Report that this proposal would enable the 2005 QSEC auctions to proceed in a timely fashion once there is clarity in the parameters that are used for setting auction prices.

One of the respondents offering qualified support explained that, whilst this modification appears to be worthy of support, in light of the two new urgent proposals (0036⁸ and 0037⁹) that have been raised they believed it more important that the earliest start date (1 September 2005) is deferred to enable parties sufficient time to consider any changes to the auction framework, whether this is as a result of UCA changes following Ofgem's recent consultation or amendments to UNC rules.

Investment lead times

Some respondents expressed concern that a delay in the auction may have consequences for investment time scales. One respondent noted that the delay in the operation of the Long Term System Entry Capacity allocation process, caused by regulatory uncertainty, should not delay the availability of any incremental capacity indicated within this year's process. The respondent suggested that Ofgem and Transco NTS review the current UNC process to ensure that where aggregate bids meet the criteria for incremental capacity at any location, unless there are exceptional circumstances, that capacity is available at 1 October 2008.

Another respondent noted that any delay would risk delaying the arrival of new gas supplies to the UK with potentially unfavourable consequences for customers and for security of supply. The respondent noted that auction participants should not suffer financial loss as a result of a delay to planned investments should this modification be implemented.

Another respondent stated that the risk of impacts on investment timescales could be mitigated by holding the auctions as soon as is practically possible after Ofgem have made their decision rather than waiting until the end of the extended period.

⁸ Modification proposal 0036 '*Limitation of incremental capacity offered in QSEC auctions*'

⁹ Modification proposal 0037 '*Limitation on offering for sale unsold capacity*', which was withdrawn 9 August 2005.

Respondent not supporting the proposal

One respondent who did not support the proposal noted that any changes to the QSEC and general auction arrangements should be managed within Transco's upcoming NTS price control review. The respondent noted that any fundamental methodology changes would undermine confidence in the arrangements.

Panel recommendation

At the modification panel meeting of 4 August 2005 all ten voting members of the panel voted in favour of the implementation of this modification proposal. The subsequent minutes of that meeting confirmed that the panel considered that the modification proposal would further relevant objectives (a) *the efficient and economic operation of the [NTS] pipe-line system* and (d) *securing of effective competition between shippers*.

Ofgem's view

Ofgem has carefully considered the views of all the respondents, including Transco NTS, on modification proposal 0030. Having had regard to the principal objective and the statutory duties of the Authority, Ofgem considers that this modification proposal better facilitates the relevant objectives (a) and (d) as set out in Standard Special Condition A11 in the Gas Transporters Licence.

Standard Special Condition A 11 (a) – the efficient and economic operation of the pipe-line system to which this licence relates

Although no change has been proposed for the level of UCAs at existing terminals, Ofgem recognises that shippers will require some time in order to prepare their bidding strategies, given that the UCA conclusions document was released 17 August 2005. If this proposal was not implemented, bidding strategies may be distorted and Transco NTS may not receive efficient investment signals in order to enable the efficient development and operation of the pipeline system. Ofgem therefore agrees with the proposer that this modification proposal would enable auction participants to provide informed investment signals to Transco NTS, which would better facilitate the efficient and economic operation of the NTS pipeline system.

It is also noted that the delay of the QSEC auctions may enable Ofgem to undertake further consultation on modification proposals 0036 and 0043¹⁰. These modifications were previously granted urgent status by Ofgem, given that they potentially affect some of the characteristics of the entry capacity regime in advance of the upcoming QSEC auctions (i.e. an imminent date-related event).

Standard Special Condition A 11 (d) securing of effective competition between the relevant shippers and suppliers

Similarly, Ofgem considers that a delay in the auctions should allow the securing of effective competition between the relevant shippers and suppliers. Ensuring that shippers have as much

¹⁰ Modification proposal 0043 'Limitation on offering for sale unsold capacity'

information available as possible in a timely manner is critical to preventing a distortion of competition. If shippers do not have sufficient time to be informed about Ofgem's decision on UCAs and to prepare their bidding strategies, this may potentially undermine competition between shippers and have a detrimental effect on the auction results.

Further, and without fettering the discretion of the Authority with respect to its decisions on modification proposals 0036 and 0043, a delay would also allow participants to consider the implications of any decision the Authority reaches on these proposals following any further consultation that is undertaken. This should better facilitate competition between shippers.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to accept the modification proposal.

If you have any further queries in relation to the issues raised in this letter, please feel free to contact Mark Feather on 020 7901 7437.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Hull', written in a cursive style.

Robert Hull
Director, Transmission