

URGENT Modification Report
Extended LTSEC Auctions at New Entry Points
Modification Reference Number 0638

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 the proposal is linked to the next long term auctions scheduled for September 2003.

Procedures Followed:

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

1. The Modification Proposal

It is proposed that the Network Code should be amended such that:

1. An Extended Auction may be operated in two stages, an initial and final stage. And will be applicable to the allocation of Quarterly System Entry Capacity only.
2. The provision of capacity through an Extended Auction will be subject to the provisions of existing paragraph B2.1 of the Network Code, which provides definitions pursuant to the allocation of entry capacity.
3. For the purposes of an Extended Auction paragraph B2.2.1 (invitation to auction) shall not apply. The new requirement shall be:
 - a. Not later than 28 days before the first invitation date for the initial stage of an Extended Auction, Transco will notify Users of the reserve prices and the step prices in respect of each applicable Aggregate System Entry Point.
 - b. The prices once published shall remain unchanged for the period of both the initial and final stages of an Extended Auction.
 - c. Transco will notify Users of the date by which the initial stage shall be completed.
 - d. The date for completion of the final stage shall be signalled at the time of the initial invitation to auction and a reminder will be issued not less than 28 days before the final stage is due to start.
4. Transco's invitation will be in accordance with existing paragraph B2.2.3 except that:
 - a. The invitation period shall be ten business days and

- b. Available System Entry Capacity and the Reserve Price shall be published for the applicable period only (at present Capacity Year +2 to Capacity Year +16).
- 5. Transco will notify Users of the prevailing relevant Step Price Group in accordance with B2.2.17, but consideration of the closure provisions shall apply only to the ASEP(s) that is subject to the Extended Auction provision.
- 6. The QSEC allocation provisions as described in paragraph B2.6 shall apply following the initial (first) bid stage except:
 - a. Following an interim stage of an Extended Auction an indicative allocation only will be determined in accordance with paragraph B2.6
 - b. Notification of allocation prices will be provisional only. Notification of volumes will be final.
 - c. Bids cannot be withdrawn following completion of the interim bid stage, including during the final bid stage.
- 7. The QSEC allocation provisions as described in paragraph B2.6 shall apply following the final bid stage except:
 - a. Determination of the allocation will take into account the aggregate of bids placed during the initial stage and bids placed in the final stage.
 - b. If following the determination of an allocation after the final stage the resulting cleared price(s) indicates a lower price than had been indicated at the initial stage (when considering initial bids in isolation), the price indicated at the final stage shall apply.
- 8. Payment shall be as for existing entry capacity arrangements.
- 9. If following the initial bid stage where no capacity in respect of an ASEP has been allocated then the final stage of the extended auction shall not be operated in respect of the ASEP.

2. Transco's Opinion

Transco, as proposer, supports implementation of the proposal.

The intention of the proposal is that for new Aggregate System Entry Points (where there is a descending price schedule) it may be possible to conduct an extended auction of system entry capacity where infrastructure investment projects are envisaged but which are anticipated to have different start up dates. This is expected to establish a clearer auction signal for future capacity requirements. Transco believes that reliance on the existing LTSEC auction process will not necessarily deliver appropriate and efficient long term market signals.

Transco would wish to deliver an efficient solution for these new entry points to enable the efficient sizing of on-shore infrastructure which should benefit Transco, upstream developers and Users of incremental entry capacity.

Transco believes that the provision of efficiently sized pipelines to take gas away from new Aggregate System Entry Points is consistent with its GT Licence obligations as well as being in the interest of the wider community.

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

Transco believes that implementation of the modification proposal better facilitates Transco's relevant objectives particularly in terms of the economic and efficient operation of its pipeline system. Where there are multiple developments planned for a new Aggregate System Entry Point the proposed modification would allow for information to be aggregated over a longer period to enable economic investment decisions and therefore economic and efficient operation. In the absence of the proposed modification there would be an increased possibility that Transco would be required to build multiple pipelines at increased cost to both Users and Transco.

The modification proposal could be seen to facilitate competition between developers and between their associated shippers in that participants would initiate development at entry points in the knowledge that capacity would be made available economically and efficiently thereby lowering any barriers to entry that would otherwise exist.

The proposal takes account of developments in the transportation system in facilitating the efficient development of capacity at a new entry point where multiple participants are involved over an extended period of time, an event unprecedented during the time of the Network Code.

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

There are no implications for the physical operation of the System.

b) development and capital cost and operating cost implications:

Through the implementation of the proposal the development and capital costs and operating costs should be incurred efficiently utilizing any economies of scale.

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:

Costs will be recovered through Transco's SO incentive.

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

There are no such consequences.

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

There are no such consequences

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

Systems development will be required to allow relevant bids to be processed over the extended period of the auction.

7. The implications of implementing the Modification Proposal for Users

Users will be able to bid for capacity at the initial stage and/or at the final stage of the auction. This should enable Users to take advantage of any economies of scale where Users who bid at the initial stage would benefit from the prices associated with the aggregate demand arising from the final stage of the extended auction. Also Users could bid at a later (final) stage of the auction as long as capacity had been allocated at the initial stage and an appropriate option fee has been paid.

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

Transco believes that the modification proposal is consistent with its licence arrangements to operate its pipeline system in an economic, efficient and coordinated manner.

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

Advantages:

The proposal should enable Transco to make efficient investment decisions in response to market signals over the planned period of development.

The proposal might enable Users to take advantage of economies of scale by enabling Users who bid in the interim stage to pay the costs associated with aggregated demand arising from the final stage of the extended auction.

There should be lower cost implications for Transco and Users by avoiding the requirement to build multiple pipelines.

Disadvantages:

None have been identified in the representations.

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:

British Gas Trading (BGT)
EDF Energy (EDFE)
ExxonMobil (EXM)
Milford Gas (MGL)
Scottish and Southern Energy (SSE)
Statoil UK (STUK)

All six respondents supported implementation of the modification proposal.

11.1 General Principles

SSE state that they support the principle of the modification proposal and believe that it is in Users' and Transco's interest to ensure appropriate arrangements are developed in relation to new entry points to ensure that the most economic and efficient system is developed.

BGT welcome the initiative to address the issue of the relative timings of new developments and recognize that it is in Users interests to ensure that optimum investment is carried out on the basis of the best possible information on future developments.

BGT believe that the principle should be extended more widely than just new entry terminals with decreasing price schedules but to any significant investment in Transco's network and therefore that the proposal is discriminatory.

EXM support the concept of an extended auction in being able to deliver efficiencies for entry points with downward sloping price curves and benefits for Users and consumers alike.

STUK support implementation of the modification proposal and state that the open season approach seems to be especially prudent when potential new developments are being planned to allow the most efficient investment scenario to be implemented.

MGL is supportive of the proposal, specifically that the mechanism should provide the correct investment signals and that interests of the bidders in the initial auction are protected.

EDFE offer support for the proposal citing the benefits for Users and Transco of clear investment signals and taking advantage of potential economies of scale.

Transco Response

Transco welcomes the support of all of the respondents of the principle of the extended auction for new entry points where multiple developments are likely to take place. However Transco believes that the extended auction should only apply to new entry points with downward sloping price curves and should not, at this stage, apply to all ASEPs whether there is planned significant investment or not. It is at new entry points where clearer benefits should be realised through economies of scale and any benefits at existing entry points are likely to be less significant.

11.2 Option Fee

SSE agree that the relevant parties should be required to fund appropriate costs i.e. the option fee associated with extending the auction. SSE stated that they assume that the option fee covers the potential risk and/or additional costs that Transco might face rather than the administration costs associated with conducting a secondary stage auction.

SSE and STUK express some concerns about the option fee including how it might be calculated, who would pay it, when it would be paid, how the revenue would be treated and how any revenue would be refunded to participants. STUK state that the methodology for establishing an option price may not be within the remit of the Network Code but that clarity is required. SSE believe that the option fee should be determined up front between the parties and Transco and that it should be refundable against any capacity payments due following completion of the final allocation of capacity.

STUK are unclear as to the treatment of the option fee if the auction closed after the initial stage because there were no bidders.

EXM express concern that there is no explanation of how the option fees would be determined or explanation of the timing by which the terms of the option would be made available. Also, that it would be helpful if Transco could engage with prospective project developers and associated Users to provide engineering rationale and background when it becomes available. EXM also state that any extension option arrangement should reflect the typical terms of Pre Works Agreements that Transco may typically sign with a developer. Also that Pre Works Agreements would continue to be available to a project developer whether or not there has been capacity allocation at the LTSEC auction or there is an extended auction.

EXM offer a process whereby Transco issue the invitation to an annual LTSEC auction stating that the default assumption is that there will be an extended auction for new entry points and that the dates for commitments to underwrite the costs of the first extension phase will be included. The latest date for the receipt of such commitments should be specified to be a date after the initial auction and after the allocation of capacity.

Transco Response

Transco agrees with those that recognize that option fees are required and that they should cover the potential risk and or additional costs that Transco might face. Transco also agrees that the pricing methodology for the option fees is outside the remit of the Network Code and that the pricing calculation will be shared with the relevant parties and Ofgem. The treatment of the revenue would be agreed with Ofgem under Transco's price control formula and that the revenue would be refundable against any capacity payments or if the extended auction did not take place because there was no capacity allocation in the initial auction.

Transco agrees with the proposal that the dates for the commitments to underwrite the costs of the first extension phase will be included in the invitation to tender and that the latest date of such commitments should be specified to be a date shortly after the allocation of capacity.

11.3 Auction Timing

SSE agree that the proposal should be implemented ahead of the September 03 LTSEC auction and state that the timing of the secondary stage should be determined upfront and agreed between the parties at the same time as the option fees are agreed in advance of the initial invitation. It is the view of SSE that there should be a firm commitment to a secondary auction once the dates have been notified with the initial invitation irrespective of whether capacity has been allocated in the initial auction.

SSE agree that Users can bid for additional capacity at the secondary stage but cannot withdraw bids. SSE also suggest some detailed changes to the legal drafting in terms of terminology for the initial and secondary auctions and the discretion of Transco to invite secondary auctions.

SSE mention that the proposal should cover modification proposal 0622, Adhoc LTSEC auctions, should that be implemented.

BGT express some reservations about the process in that developments may not conveniently coincide with LTSEC auctions. Also, the extended auction period may not afford sufficient time for participants to be in a position to commit to the purchase of LTSEC and that the LTSEC process is insufficient in itself to drive the investment programme and that other intelligence such as the annual planning process will play an essential role to play in the planning of Transco's networks.

EXM express concern that the latest date that shippers must commit to an extension is September which could be a short period following the conclusion of the initial invitation date and that there is no commitment to a secondary invitation.

STUK state that it is not clear how it is established that an extended auction is required or on how the interval between the auctions is established. Also, whether the initial auction dates have to be the same as the normal auction invitation dates.

STUK comment that it may not be appropriate for Transco to stop the final auction taking place if there were no bids at the initial auction phase and that it may be that none of the parties involved would be in a position to bid for capacity in the initial auction but would require capacity in the final auction.

MGL has a concern that the invitation for the secondary auction should be issued no later than 30 September which would be okay where the auction takes place in early September but MGL offer that where auctions at new entry points may take place on other dates it may be more sensible to issue the invitation for the secondary auction at a fixed time period (e.g. 28 days) after the first auction.

Transco Response

Transco agrees that auction signals although important are not the only source of information to inform investment decisions and that intelligence from the annual planning process also has an essential role to play, however Transco believes that the extended auction period should afford time for participants to commit to LTSEC.

The requirement for an extended auction would be initiated by Transco in response to an approach from parties who were considering multiple developments at an entry point.

Transco does not believe a secondary auction should take place if capacity has not been allocated in the initial auction. The rationale for the extended auction is that it allows parties to make two sets of bids, not just one set of bids at the final stage. Transco has set out the criteria that must be met for the secondary stage of the auction to take place i.e. that capacity must be allocated in the initial stage and that option fees must be paid by participants. The legal drafting has been amended to reflect that the decision to proceed with an extended auction is not limited to 30 September.

The auction dates for the initial stage of the extended auction will not necessarily be the same as the normal invitation dates.

Transco agrees that the terminology should refer to initial (rather than “interim”) and secondary auctions and the proposal has been amended to reflect this.

Transco believes that the modification proposal covers the potential implementation of modification proposal 0622, Adhoc LTSEC auctions.

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

Implementation is not required for this purpose.

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

Implementation is not required having regard to any such proposed change.

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

There would not be a significant programme of works.

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

Proposal agreed as urgent	08/07/03
Circulate to Users requesting representations	08/07/03
Representations close out	24/07/03
Final Modification Report to Ofgem	28/07/03
Ofgem decision expected	31/07/03

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of this 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

Proposed legal text

SECTION B: SYSTEM USE AND CAPACITY

Add new paragraph 2.2A to read as follows:

2.2A New Aggregate System Entry Points and System Entry Capacity auctions

2.2.1A For the purposes of this paragraph 2.2A:

- (a) a "**New**" Aggregate System Entry Point is an Aggregate System Entry Point in respect of which Transco has not previously held an annual invitation in accordance with paragraph 2.2 or this paragraph 2.2A;
- (b) an "**initial**" quarterly capacity bid is a capacity bid submitted on an initial annual invitation date and a "**secondary**" quarterly capacity bid is a quarterly capacity bid submitted on a secondary annual invitation date.

2.2.2A By not later than the Day falling twenty eight (28) Days before the first initial annual invitation date, Transco will notify Users of the applicable reserve prices and the step prices that will apply in respect of the New Aggregate System Entry Point for the purposes of the first annual invitation.

2.2.3A Transco will invite applications ("**first**" annual invitation) for Quarterly System Entry Capacity at the New Aggregate System Entry Point for each calendar quarter in Capacity Year + 2 to Capacity Year + 16 (inclusive) for such aggregate amounts of System Entry Capacity as is specified in the first annual invitation and Users may make applications for System Entry Capacity in respect of the New Aggregate System Entry Point in accordance with this paragraph 2.2A.

2.2.4A Transco's annual invitation under paragraph 2.2.3A will specify:

- (a) the date(s) on which applications ("**initial applications**") pursuant to the first annual invitation may be made, which shall be a period of ten (10) consecutive Business Days, (each such date an "**initial**" annual invitation date);
- (b) the date(s) on which further applications ("**secondary applications**") pursuant to the first annual invitation may be made, which shall be a period of ten (10) consecutive Business Days, (each such date a "**secondary**" annual invitation date);
- (c) the conditions which must be satisfied before Transco will invite Users to submit secondary applications;
- (d) for the New Aggregate System Entry Point, and in respect of each of Capacity Year + 2 to Capacity Year + 16 (inclusive), the Available System Entry Capacity and the applicable reserve prices for Baseline System Entry Capacity (in accordance with the Transportation Statement) (the "**applicable reserve price**");

- (e) for the New Aggregate System Entry Point, and in respect of each of Capacity Year + 2 to Capacity Year + 16 (inclusive):
 - (i) the relevant number of incremental capacity amounts of Quarterly System Entry Capacity greater than the Baseline Entry Capacity (the maximum incremental capacity amount being not less than an amount equal to 150% of Baseline Entry Capacity); and
 - (ii) the step price payable by Users for each different incremental capacity amount were Transco to make such incremental capacity amount available,

in each case (in accordance with the Transportation Statement); and

- (f) the relevant number for the purposes of paragraph (d) being twenty (20) except in event of a New Aggregate System Entry Point where the Baseline Entry Capacity is less than 300,000,000 kWh/Day where the relevant number (being not greater than twenty (20) and not less than five (5)) as set out in the Transportation Statement.

2.2.5A Provided the conditions referred to in the first annual invitation are satisfied Transco will by not later than the Day falling twenty-eight (28) Days before the first Day on which Users may submit secondary applications re-notify Users of each of the secondary annual invitation date(s), and Transco's invitation will be in accordance with paragraph 2.2.4A and the applicable reserve price shall be the same as that applicable reserve price that applied when Users were invited to submit initial applications.

2.2.6A Users may apply for Quarterly System Entry Capacity for a calendar month in each of Capacity Year + 2 to Capacity Year + 16 (inclusive) in respect of the New Aggregate System Entry Point on initial annual invitation dates and on secondary annual invitation dates (and a User who has not submitted an initial application shall not be prevented from submitting a secondary application where Transco invites secondary applications).

2.2.7A For the avoidance of doubt, and without prejudice to the further provisions of this paragraph 2.2.A, in relation to a first annual invitation:

- (a) paragraphs 2.2.5, 2.2.6, 2.2.8, 2.2.10, 2.2.11 and 2.2.12 shall apply;
- (b) paragraph 2.2.9 shall apply provided that an initial quarterly capacity bid may not be withdrawn on a secondary annual invitation date;
- (c) paragraph 2.2.17 shall apply for which purposes the prevailing relevant step price group shall be determined by reference to the quantities of Quarterly System Entry Capacity applied for in aggregate at the New Aggregate System Entry Point by Users up until 17:00 hours on each relevant invitation date).

2.2.8A Without prejudice to paragraph 2.2.9A, following the submission of initial applications in relation to the New Aggregate System Entry Point paragraph 2.6 shall apply and Transco shall allocate System Entry Capacity and Users will be registered as holding Quarterly System Entry Capacity at the New Aggregate System Entry Point in the amounts so allocated.

- 2.2.9A Where Transco invites and Users submit secondary applications in relation to the New Aggregate System Entry Point paragraph 2.6 shall again apply for which purposes the Reserve Price Bid Amount and the relevant step price group shall be determined by reference to initial quarterly capacity bids and secondary quarterly capacity bids and Transco shall allocate or (as the case may be) reallocate System Entry Capacity and Users will be registered as holding Quarterly System Entry Capacity in the amounts so allocated or (as the case may be) reallocated.
- 2.2.10A For the avoidance of doubt following the allocation of System Entry Capacity under paragraph 2.2.9A Users agree to pay by way of System Entry Charges for the Quarterly System Entry Capacity allocated the step price corresponding to the relevant step price group for the calendar quarter following the second application of paragraph 2.6 irrespective of whether or not the step price is the same as the step price corresponding to the relevant step price group following the first application of paragraph 2.6 in respect of initial applications.
- 2.2.11A Nothing in this paragraph 2.2A shall be construed as giving rise to a requirement that Transco make available System Entry Capacity in relation to the New Aggregate System Entry Point on secondary annual invitation dates or that Transco invite Users to submit secondary applications.

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 **0638**, version **1.0** dated **29/07/2003**) 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 appropriateprovided 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.