



Shippers, Transco and other interested parties

*Bringing choice and
value to customers*

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Dear Colleague,

Modification Proposal 0646 'Bring forward AMSEC auctions to January to allow for two months notice of any changes in charges'

Powergen raised modification proposal 0646 *'Bring forward AMSEC auctions to January to allow for two months notice of any changes in charges'* on 19 August 2003.

Ofgem has carefully considered the issues raised in this proposal and has decided to direct Transco not to implement this proposal because we consider that it does not better facilitate the relevant objectives of Transco's network code, as set out under standard condition 9 of Transco's gas transporter (GT) licence.

In making this decision Ofgem has taken into account Transco's obligations under its GT licence, our wider statutory duties and all relevant facts.

We have set out below the reasons for our decision not to direct Transco to implement modification proposal 0646.

Background to the proposal

System Entry Capacity Auctions

Transco has allocated monthly system entry capacity (MSEC) rights to access the national transmission system (NTS) via six monthly entry capacity auctions since September 1999. Transco also releases firm and interruptible capacity on a daily basis where there is additional capacity available. In addition, in the event that expected flows exceed both the capability of the system at an entry point and the amount of capacity held by shippers at that terminal, Transco is able to scale back interruptible capacity and to the extent necessary, buy back firm entry rights at market determined prices.

Following Ofgem's approval of modification 0500, '*Long Term Capacity Allocation*', Transco also makes available 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 a subsequent auction occurring in September 2003 for the period April 2005 to March 2020.

The first annual monthly system entry capacity (AMSEC) auction was held in August 2003 for the period October 2003 to March 2004 (a transitional period). Following the implementation of modification proposal 0616 the next AMSEC auctions are currently scheduled to occur in February 2004, for capacity for the following April 2004 to March 2005.

Transco's transportation charges

The modifications made to Transco's GT licence on 27 September 2002 established Transco's Transmission Asset Owner (TO) price control for 2002–2007 and put in place a series of System Operator (SO) incentives for the NTS. The modifications took effect from 1 April 2002 and separated the regulation of Transco's role as TO whereby it builds and maintains the NTS, from its role as SO whereby Transco determines the need for additional capacity and operates the NTS on a day-to-day basis.

Transco levies transportation charges on shippers to recover its NTS allowed revenue as determined under its price control. In particular, Transco collects its NTS TO allowed revenue through entry and exit capacity charges and its NTS SO allowed revenue through an SO commodity charge. Transco is required to use its best endeavours in setting its charges to ensure that, in respect of any formula year, the

revenue from such charges does not exceed its price controlled maximum allowed revenue for each of its TO and SO controls.

Transco may need to adjust the level of its transportation charges periodically in order to ensure that it meets its price control obligations. Changes of this nature may be required in the event that Transco has incorrectly forecast its expected revenues for a formula year. In addition, where revenues received from entry capacity auctions suggest that Transco may exceed its allowed revenue for a particular year, charges may be adjusted to ensure Transco does not over recover against this allowed revenue.

Under the provisions of its GT licence, Transco must use reasonable endeavours to give the Authority notice of a proposal to change its charges at least 150 days before the proposed date of implementation.

Further, under the current network code arrangements, Transco is required to provide no less than two months notice prior to the implementation of any revised transportation charges.

Ofgem has previously indicated that Transco should give consideration to revising its transportation charges once a year only, with sufficient notice being given to shippers of this change.¹ In particular, Ofgem has stated that restricting changes to transportation charges on an annual basis would facilitate competition in the wholesale gas market.

Provision of maintenance information

Transco is currently required, under Section L of the network code, to prepare and publish a maintenance programme outlining planned maintenance of the NTS. The maintenance programme identifies the duration and expected impact of planned

¹ See for example, Ofgem's decision letter with respect to Transco's Pricing Consultation paper PC 75, '*NTS TO Commodity charge*' and Ofgem's decision letter approving network code modification proposal 0576, '*Provision of information relating to the SO commodity charge*'.

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 twelve months of the planning period.

Shippers 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 shippers' 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. Shippers 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 shippers' comments. These comments are required to be submitted by 15 September.

Related modification proposal

0655 Separate to this proposal, Shell Gas Direct has raised modification proposal 0655, '*Price Change Notification Periods*'. This proposal provides that Transco should be obliged to publish price changes at least 3 months ahead. It should also be required to publish indicative prices 3 months prior to this (i.e. 6 months before

implementation). Furthermore, after the publication of indicative prices and before the publication of final prices, it is proposed that Transco should use its best endeavours to ensure that it informs shippers as soon as practicable of any change to its assumptions/data that it becomes aware of that could have a material effect on the final prices published.

The proposal

Powergen has proposed a revision to the timing of the AMSEC auction process in order to provide two months notice of any changes in charges that become necessary as a result of the auctions and allow the new charges to take effect from April. Powergen suggested that the AMSEC auctions occur in January of each year for capacity for the following 1 April (Y) to 31 March (Y+1). Powergen noted that this would require Transco to publish an indicative maintenance schedule at least one week prior to the AMSEC auctions in January, preferably in December.

Respondents' views

Of the ten responses received to this modification proposal, the majority of respondents did not support bringing forward AMSEC auctions to January.

Effect on transportation charges

Respondents supporting the proposal argued that the move to an AMSEC auction within January would allow a timely revision to transportation charges, where required. Some respondents considered that this approach would deliver certainty of transportation charging during customer tendering processes, thus facilitating competition between shippers and suppliers.

Of the respondents who did not support the proposal, some suggested that, as the period in which LTSEC was sold approaches, the recovery from the AMSEC auctions should become less significant and would have limited effect on the prevailing transportation charges. One respondent also stated that AMSEC auctions will not necessarily lead to all capacity being sold in any event.

A number of respondents, including some of those who supported the proposal, noted that, according to network code rules, Transco can amend transportation charges throughout the year, regardless of when the auctions are held.

Timing of the auctions and impacts on the draft April maintenance programme

Most respondents shared concerns that holding auctions significantly before the commencement of the Gas Year could possibly increase uncertainty, especially due to earlier publication of Transco's draft April maintenance programme.

Respondents commented that this could result in an inefficient outcome and may potentially increase the likelihood of a price adjustment.

Some respondents supporting the proposal considered that any auction held in January should be held at least one week after the publication of Transco's draft April maintenance programme.

Some respondents expressed concerns about the proximity of the auctions and the publication of the indicative maintenance schedule to a long holiday period, suggesting that there may be difficulties in terms of personnel and management of other business demands.

Another respondent who was against the proposal stated that February is the optimal date to obtain the most reliable information on the Summer Maintenance programme, without being so late as to prejudice the allocation of capacity and adjustments of prices arising from that allocation.

Transco's views

Transco offered support for this proposal. It considered that bringing forward AMSEC auctions to January would better facilitate the relevant objectives of its network code. In particular, it considered that the proposal would better facilitate the securing of effective competition between shippers and suppliers by increasing certainty in costs and charges during the tendering process.

Transportation charge stability

Transco agreed with the proposer that this modification proposal enables transportation charging adjustments arising from entry capacity auctions to be implemented in a timely manner and in accordance with network code, which requires that 2 months notice is provided before implementing any changes to transportation charges.

Transco also stated that an advantage of implementing this modification proposal would be the avoidance of further modification proposals to implement short notice

transportation charge rate revisions resulting from any possible entry capacity auction revenue over or under recovery.

Timing of the auctions and impacts on the draft April maintenance programme

Transco noted the concerns expressed by shippers about the level of additional uncertainty to the programme content introduced by earlier publication of the draft April maintenance programme. However, Transco stated that it will continue to deliver a draft maintenance programme reflecting information gathered by Transco and submitted by shippers in accordance with the network code. It also considered that the materiality of this issue is difficult to assess, given that potential new information is unpredictable by its nature. Transco did not comment on any price volatility implications and its sensitivity to maintenance information.

Although Transco agreed that as a consequence of the introduction of LTSEC auctions the amount offered in AMSEC auctions may reduce compared to past experience, it considered that prices arising from AMSEC auctions will continue to be uncertain and the need for a charge adjustment resulting from AMSEC processes cannot be ruled out.

As regards the considerations about limited resources during a long holiday period, Transco agreed that the availability of key personnel is an issue that all parties should consider when planning activities around holiday periods.

Ofgem's views

Ofgem recognises that a number of respondents considered that holding the AMSEC auctions in January would allow two months' notice of any consequential changes in charges to take effect from April, potentially increasing certainty in transportation costs and charges during customer tendering processes.

Whilst we understand this request, we do recognise the issues raised by several respondents who were against the proposal on the basis that the quality of Transco summer maintenance information may be reduced were an auction to be held in January rather than February.

In the case of this proposal, Ofgem considers that there is a balance to be achieved between charging certainty and enabling shippers to access capacity close to the period of physical delivery based on robust maintenance information. Based on the views expressed in the consultation, Ofgem believes that, on balance, it is preferable

to retain the present February AMSEC auction timetable. We consider that this approach would better facilitate competition between shippers and suppliers.

In particular, holding auctions in February should ensure that bidding occurs on the basis of the most up to date information available on Transco maintenance (as well as a shipper's own projected gas flows). This should ensure that shippers are better able to value the entry capacity rights, which they purchase in AMSEC auctions.

Ofgem considers that this will also 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. By moving the auctions to January, these efficiency benefits could be reduced. Whilst the reduction in benefits may be offset to some degree by increasing certainty in transportation charges Ofgem would note that in any event, the provisions of Transco's network code require it to give no less than two months' notice of such changes.

Ofgem notes that separately, Shell Gas Direct has raised modification proposal 0655 which provides for an extension to the present two month notice period contained in the network code with respect to transportation pricing changes. This proposal is currently out for consultation, which will provide industry participants with a further opportunity to discuss the issue of notice periods and certainty in transportation charges.

Ofgem's decision

Ofgem has carefully considered the issues raised by this modification proposal in relation to the timing of future AMSEC auctions. For the reasons outlined above, Ofgem has directed Transco not to implement this modification proposal because we do not consider that it would better facilitate the achievement of the relevant objectives as set out in amended standard condition 9 of Transco's GT licence.

If you require any further information in relation to this modification proposal please feel free to contact me on the above number or Tolani Azeez and Matteo Guarnerio on telephone 0207 901 7043/7436.

Yours sincerely



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Head of Gas Trading Arrangements