

Modification Report
Offering capacity at Donor ASEP in Trades & Transfers Process
Modification Reference Number 0163
Version 1.0

This Modification Report is made pursuant to Rule 10.1 of the Modification Rules and follows the format required under Rule 10.2.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 10.1.2, Ofgem agreed that this Modification Proposal should be treated as Urgent because it considered that the Proposal was linked to the following two criteria:

1) There is a real likelihood of significant commercial impact upon Gas Transporters, Shippers or Customers if a proposed modification is not urgent

It was suggested that the additional provisions raised in this proposal need to be considered at the same time as Proposals 156/156A “Transfer and Trading of Capacity between ASEPs”. This Proposal raises a number of issues that, if not considered, could, it was suggested, lead to a detrimental impact on the trade and transfer mechanism should either Proposal 156 or 156A be adopted.

3) The proposal is linked to an imminent date related event

It was suggested that a decision on this Proposal needed to be made before the trade and transfer process was initiated. As stated above, it was suggested that these issues be considered at the same time as Proposals 156/156A, which seek an implementation date prior to the winter period (1 October 2007 to 31 March 2008).

Given the potential commercial impact identified above, Ofgem agreed that, in these circumstances the transfer and trade of capacity between ASEPs was an imminent date related event for the purposes of these criteria.

Procedures Followed:

The procedures agreed with Ofgem for this Proposal were:

Process	Date
Ofgem grant urgency status	24/07/2007
Proposal issued for consultation	25/07/2007
Discussion at Transmission Workstream	02/08/2007
Close out of representations	03/08/2007
FMR issued by Joint Office to Modification Panel	06/08/2007
Modification Panel decide upon recommendation	07/08/2007
Ofgem decision expected	10/08/2007
Proposed implementation date	13/08/2007

1 The Modification Proposal

National Grid NTS has a licence obligation to introduce trades and transfers for entry capacity rights in the constrained period. The principal aim is to move capacity from where it is not required to where it is. Under the arrangements proposed within Modification Proposals 0156 and 0156A “Transfer and Trading of Capacity between ASEPs”, there are provisions for the trade and

transfer of sold and unsold capacity. A problem with this approach is that it may allow for the transfer away of capacity rights at a sold-out ASEP where there is still unsatisfied demand. This unsatisfied demand might be required at the ASEP at which it was bid. Apart from such inefficiency, there is also serious potential for gaming, thanks the ability to transfer capacity away from these ASEPs - effectively “shutting down” storage sites or entry terminals. Along with the moving of the firm rights goes interruptible rights under the existing rules.

This Proposal seeks a simple solution to ensure that such speculative behaviour is not rewarded, but more importantly that such unintended consequences are avoided, whilst ensuring that nobody who has secured capacity rights with a view to trade and/or transfer loses out financially.

It is proposed that, in addition to all the provisions embodied within 0156A, the following provisions shall be included:

Basically, capacity surrendered for the trades and transfers process within zone will be offered firstly at the Donor ASEP – this will ensure that the capacity is made available where it is required at the entry point at which it was purchased. This would be offered at a reserve price based on the price paid at auction. It could be argued that this will still reward speculative behaviour but applies only to the auctions for 07/08, and will not encourage future speculative behaviour.

All remaining capacity volumes will be available for trade and transfer at the relevant exchange rate within and between zones, ensuring that capacity is moved away from where it is not required to where it is.

2 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates;

Implementation of this Proposal would, it was argued, remove the inefficiency of being able to transfer or trade capacity away from where it was required, at a storage site or other entry point.

Some respondents, however, believed that implementation would prevent the efficient outcome of the Trades and Transfers process as less Entry Capacity would be transferred to where it was most valued.

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition:

(i) between relevant shippers;...

Implementation of this Proposal would, it was argued, enhance competition by taking away the ability to game and shut down specific ASEPs. This possibility would also present a barrier to entry for people interested in developing new entry points.

As this Proposal and Proposals 0156/0156A are of a temporary nature, implementation would not directly remove the ability for Users to game in the

2008 AMSEC auctions but would, potentially, remove or restrict the benefits of any speculative behaviour in the 2007 AMSEC auctions. Some respondents argued that the opposite was the case in that implementation might benefit those that deliberately withheld participation in the 2007 AMSEC auctions in order to obtain further capacity at a low weighted average price. Both these arguments rely on the speculator anticipating the implementation of the relevant Proposal.

However, some respondents pointed out that implementation would restrict the ability of Users to transfer capacity to a place where it is most valued. Implementation would instead allow Users at sold-out ASEPs to have preferential rights to acquire capacity at a price that might not be market reflective.

CoP believed that the complex process introduced at a result of implementation would constitute a barrier to entry of new shippers.

NG UKD believed that competition between Users would be restricted.

Standard Special Condition A11.1 (e): so far as is consistent with subparagraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers;

Implementation of this Proposal would enhance security of supply for domestic customers because it would ensure that storage sites or entry points cannot be shut down. In a gas deficit, or at periods of high demand, it will ensure that gas can flow from these facilities.

3 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

Implementation would help maintain the level of storage available to the market in the event of a gas deficit emergency and at periods of high demand. It would also mean that capacity could not be transferred away from entry terminals where it is required to flow gas into the system.

4 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

No adverse implications have been identified. Greater efficiency of capacity allocation could potentially reduce the requirement for the National Grid NTS to take balancing actions.

b) Development and capital cost and operating cost implications:

It is believed that the consequences for Entry Capacity income would be neutral.

One respondent believed that providing Users with a second opportunity (particularly in the case where there is only one active User) could affect prices

set at the initial QSEC and AMSEC auctions, with a subsequent impact on the signals which should be derived from these auctions.

c) Extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

Existing mechanisms would be applied to redistribute Entry Capacity income.

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

No such consequences have been identified.

5 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

No such consequence has been identified.

6 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

No such implications have been identified.

7 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

Could be part of the preferred trades and transfer methodology, hence little administration or additional procedures are required. Might work more smoothly as part of a multi-round auction, but could also work as one-round two-phase process.

However, some respondents believe that implementation would extend the complexities of the proposed Trades and Transfers process.

Development and capital cost and operating cost implications

These would be similar to those identified for Proposals 0156/0156A but Users wishing to acquire capacity at the ASEP that capacity was surrendered would probably face less costs than under either of these Proposals.

Consequence for the level of contractual risk of Users

Implementation would reduce the risk of gas being stranded at individual ASEPs due to the speculative behaviour of others that have obtained capacity at the same ASEP.

However some respondents pointed out that this possibility was discussed prior to the 2007 AMSEC auctions and this would have given Users the ability to acquire capacity at the required ASEP so reducing this risk.

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

Under the proposed arrangements, where storage operators operate at a site with no third party access, i.e. only one party is actually using the ASEP, all the capacity required can be transferred away from the site – including interruptible rights. This proposal will ensure that in such circumstances, there are still firm rights available for those who need to operate the site.

Also, this will prevent people from being able to take capacity away from any ASEP where it is most required and there is unsatisfied demand.

9 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

No such consequences have been identified

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

Advantages

- Would avoid gas in storage being stranded and unable to be brought into market when needed this coming winter.
- Would avoid inefficiencies associated with moving capacity away from an ASEP where it is required.
- Would reduce the reward for previous speculative behaviour, gaming and hoarding, based on the expected outcome of Trading and Transfer Proposals.

Disadvantages

- Potentially, people could buy capacity at the Donor ASEP to prevent it going through the trades and transfer process, (although there is no commercial incentive to do so).
- Might reward previous speculative behaviour based on the expected outcome of this Proposal.
- Would reduce the ability of Trades and Transfer auction participants to move ASEP capacity to where it was most valued.

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

Representations were received from the following:

British Gas Trading	(BGT)	Not in Support
Centrica Storage Limited	(CSL)	Not in Support
ConocoPhillips	(CoP)	Not in Support
EDF Energy	(EDFE)	Qualified Support
E.ON UK	(E.ON)	Not in Support
National Grid Distribution	(NG UKD)	Not in Support
National Grid NTS	(NG NTS)	Not in Support
Scotia Gas Networks	(SGN)	Not in Support
Scottish and Southern Energy plc	(SSE)	Not in Support
ScottishPower	(SP)	Support

Thus one respondent supported implementation, one offered qualified support and eight did not support implementation.

EDFE's qualification referred to the fact that only sold capacity would be included in the initial allocation at the same ASEP.

In addition to the comments summarised above, some respondents believed that due to the time constraints the Proposal was too reliant on details to be clarified when the legal text was produced. NG NTS consequently suggested that a variation be raised by the Proposer to clarify the issues discussed at the Transmission Workstream.

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

No such requirement has been identified.

13 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

No such requirement has been identified.

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

As with Proposals 0156/0156A, National Grid NTS would need to do the preparatory work so that it could accept Entry Capacity surrendered by Users and conduct the Trade and Transfer Auction(s). This would include providing relevant information to Users. No further programme for works has been identified as a consequence of the additional allocations within this Proposal.

15 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

This Proposal could be implemented following acceptance of the Trades and Transfer Methodology Statement, which is the subject of separate consultation.

16 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No such implications have been identified.

17 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

18 Transporter's Proposal

This Modification Report contains the Transporter's proposal not to modify the Code and the Transporter now seeks agreement from the Gas and Electricity Markets Authority in accordance with this report.

19 Text

At the request of Ofgem, legal text has been provided and forms part of this Final Modification Report. However, in view of the size of documents associated with these Modification Proposals, the text has been published separately alongside this Report.

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters