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Transco, Shippers and Other Interested Parties

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1 August 2002

Dear Colleague,

Transco Price Control and SO incentives 2002-7 – Proposed licence modifications

On 12 April 2002, Ofgem published a notice ("the Original Notice") under section 23(3) of the Gas Act 1986 (the Act) that proposed modifications to Transco's gas transporter ("GT") licence, to introduce with effect from 1 April 2002¹, new price controls and system operator incentives. The Original Notice was divided into two parts – Part A which related to the price control changes generically and Part B which related to the disclosure of system operation information and the ability of third parties to raise modifications to Transco's Network Code.

Also published on 12 April 2002 was an explanatory document ("the Explanatory Note")² to accompany the Original Notice, both of which are available on Ofgem's website at www.ofgem.gov.uk.

The period for responses to the licence consultation closed on 24 May 2002. Since that time, Ofgem has been carefully considering the responses received to the consultation. No confidential responses were received and none were withdrawn. The responses have been placed in Ofgem's Research and Information Centre³.

In the light of the responses that have been received, and following further discussions with Transco and other interested parties, Ofgem has identified a number of drafting changes to the proposed licence modifications as originally consulted on. A list of the changes to the modification attached to the Original Notice are set out in the 'Log of Changes to the Proposed Licence Modifications' ("the Log") published by the Authority earlier today.

¹ A Press Release dated 22 February 2002 and titled *Transco Price Control and System Operator (SO) Incentives Licence Modifications, Ofgem Announcement* was issued prior to the release of the Original Notice.

² *Transco price control and NTS SO incentives 2002-7, Explanatory notes to accompany the section 23 notice of proposed modifications to Transco's gas transporter licence*, Ofgem, April 2002.

³ The Ofgem Research and Information Centre can be contacted on 020 7901 7003 or 020 7901 7004.

In general terms, the changes identified fall within five broad categories (this description is not exhaustive and some changes may fall into one or more of these categories):

1. Correction of typographical errors.
2. Adding in missing words (for example, to ensure use of a defined term) or clarifying the intent expressed in the Original Notice and the Explanatory Note.
3. Restructuring of some drafting, notably in respect of the Incremental Entry Capacity Release statement to deliver the intended effect of the Original Notice and Explanatory Note.
4. Algebraic changes to produce the effect set out in the Original Notice and Explanatory Note.
5. Consistency changes.

Most of the changes identified are in respect of Part A of the Original Notice.

Having considered the changes identified, the Authority has concluded that the licence modification proposals, as amended by the changes identified in the Log, fall within section 23(6) of the Act and are consistent with the Original Notice and the Explanatory Note. As such, the Authority is satisfied that it has the power to direct that the modifications be made in their amended form.

However, several of the respondents suggested that if the Authority decided to make changes to the modifications, there should be a further consultation. Having considered this, the Authority has decided on this occasion that it is appropriate to seek views on the changes that have been identified by means of a second consultation. However, the Authority has decided to restrict this second consultation to the proposed licence modifications contained in Part A only of the Original Notice. As such, the Authority is not reconsulting upon the proposed modifications contained in Part B. It is important to note that in deciding to reconsult on Part A only the Authority has not reached a decision in respect of Part B. No decision will be made until after the close of this second consultation.

Ofgem considers that the further consultation with respect to Part A only will allow respondents an additional opportunity to scrutinise the drafting of the proposed licence modifications and to comment upon the further changes that are being proposed. For the avoidance of doubt, no inference should be drawn in relation to this consultation or any other consultation that the Authority would always reconsult in these circumstances.

Against this background, Ofgem has today issued a further section 23 notice ("the Second Notice") in respect of Part A only of the proposed modifications to Transco's GT licence to introduce, from 1 April 2002⁴: the National Transmission System (NTS) Transmission Asset Owner (TO), and Local Distribution Zone (LDZ) revenue restrictions, the metering tariff caps and the NTS System Operator (SO) incentive arrangements.

As outlined above, although the Part B modifications have been included in the Second Notice, the Authority is not reconsulting on Part B. You will note from the Log that there are two changes to the Part B proposals that have been identified – these address incorrect cross references and do not require further consultation. The Part B proposed licence modifications

⁴ See footnote 1.

have been included in the Second Notice for information purposes only so that respondents can consider the proposed changes to Transco's GT licence as a whole. The Part B proposed licence modifications **DO NOT** form part of the statutory consultation in respect of the Second Notice and proposed licence modifications issued with it.

This letter should be read in conjunction with the Second Notice, the proposed licence modifications issued with the Second Notice (which take account of the changes identified in the Log) and the Log itself which details the changes that have been made to the drafting of the proposed licence modifications since the first consultation issued on 12 April 2002. Each of the documents described above (and the documents referred to in the Original Notice) can be obtained from Ofgem's website.

The Second Notice

In issuing the Second Notice, Ofgem has considered all responses received. Ofgem asks respondents to refrain from repeating comments previously made unless it is considered that the changes proposed are such that Ofgem should reconsider the comments. Respondents are of course free to comment on any matters that they consider should be drawn to the Authority's attention.

Summary of Changes proposed under the Second Notice

Ofgem considers that it may be helpful to summarise some of the key changes in the legal drafting between the Original Notice and the Second Notice. However, this summary does not act as a complete and exhaustive list of changes between the Notices – this can be found in the Log. In addition, this summary is set out for ease of reference only and does not affect the content of the Second Notice.

Special Condition 27

Ofgem has modified the dates by which the Procurement Guidelines and System Management Principles Statement are to be prepared. In the proposed licence modifications issued on 12 April 2002, this condition provided that the statements were to be prepared by 1 July 2002. The revised proposed licence conditions issued today now specify that the statements are to be prepared by 1 October, or such later date as the Authority may direct.

Special Condition 28B, Part 2 paragraph 14(5)

Ofgem has modified the date by which Transco is required to use all reasonable endeavours to ensure that all long-term firm SO baseline entry capacity for formula years 1 to 5 at each terminal is offered for sale. The proposed licence modifications issued on 12 April 2002 specified that Transco was to meet this reasonable endeavours obligation by 1 October 2002. However, given the revised timetable outlined below, Ofgem has decided in the revised proposed licence modifications to amend this date to 1 November 2002.

Ofgem has also proposed amendments to this proposed licence condition to clarify the point at which an obligation to offer incremental entry capacity will begin. The changes also seek to establish a timetable for the assessment of incremental entry capacity proposals and to clarify the

circumstances in which Ofgem may direct, or not as the case may be, the implementation of a proposal.

Special Condition 31

Ofgem has modified the formula for the metering tariff caps so it has the intended effect as set out in the Explanatory Note that accompanied the Original Notice. In addition, changes were made to paragraph 4 of the proposed licence condition to clarify that any increased charges apply only to specific shippers. These modifications are set out in detail in the Log.

Special Condition 34

In the revised proposed licence modifications issued today, Ofgem has modified the date by which the Incremental Entry Capacity Release statement is to be prepared. In the proposed licence modifications issued on 12 April 2002, this condition provided that the statement was to be prepared by 1 July 2002. The revised proposed licence conditions now specify that the statement is to be prepared by 1 October, or such later date as the Authority may direct.

In addition to these modifications, there are a number of other modifications that Ofgem has made to Part A of the proposed licence modifications that were issued on 12 April 2002. These modifications, as well as the ones described above, are outlined in more detail in the Log that accompanies the Second Notice issued today.

Proposed timetable

This consultation on the proposed licence conditions issued today will of course have an impact on the timing of the long-term entry capacity auctions. In the light of this further consultation, Transco is now proposing that the long-term auctions take place in early October 2002, subject to Ofgem's consideration of Network Code modification proposals 0500, '*Long-term capacity allocation*' and 0508, '*Method of long-term capacity allocation*'. Transco's decision in this regard obviously does not fetter the Authority's discretion in respect of this or any other Network Code modification proposals.

Looking ahead, an indicative timetable is as follows –

- 1 August 2002 – Second Notice is issued.
- 30 August 2002 – closing date for responses to the Second Notice.
- Subject to the nature and extent of the responses to this consultation, it is Ofgem intention to issue its decision in respect of this consultation in early September.
- Subject to the above, the long-term entry capacity auctions should begin during the week commencing 7 October 2002.

Ofgem has discussed this indicative timeline with Transco and Transco has confirmed that it is content with a timetable as indicated above (subject to the outcome of the statutory consultation), and that it should be able to use the results of the auction in finalising the NTS projects to be undertaken in 2004.

Shippers have expressed concern that they will not be able to begin preparing their auction strategies until they have seen the definitive versions of all the supplementary statements, and in particular, the proposed Incremental Entry Capacity Release Statement. Ofgem understands this concern and we have advised Transco that we consider that it is essential that the statements are finalised close to the time at which the proposed licence condition is brought into effect (subject to the outcome of the consultation).

In this respect, Transco has therefore indicated to us that it will undertake to work towards finalising the statements throughout August with a view to having the statements approved by Ofgem in early September (subject to the outcome of the licence consultation). In order to achieve this it may be necessary for Transco to further consult with shippers on the statements during August.

In their consultation responses to the long-term auction modification proposals as well as in discussions with Ofgem, several shippers have also indicated that they would prefer not to be preparing for the auctions during the summer holiday period and that they need more than 4 weeks to prepare their strategy. This revised timetable should, we hope, go some way to addressing shippers' concerns on these points.

In terms of the long-term auctions Transco has indicated to Ofgem that it will shortly be issuing the final modification reports for modification proposals 0500 and 0508. In the event that respondents have any further views on either of these proposals they are of course able to send such views to Transco and Ofgem.

National Grid plc and Lattice Group plc merger

In April 2002, National Grid Group plc ('NGC') and Lattice Group plc ('Lattice') announced their intention to merge to create National Grid Transco plc. The Secretary of State subsequently cleared this merger on 2 July 2002.

As part of the merger process, Ofgem is currently undertaking a consultation in which it is seeking views on a modification to strengthen the proposed Special Condition 26 of Transco's licence (if the modification proposal published on 12 April 2002 and subsequently reissued today is implemented) to prevent related undertakings as well as affiliates from buying or selling gas except with Ofgem's consent whether as principal or agent. A modification of this nature would bring Transco's licence into line with NGC's licence.

Ofgem will decide whether or not to proceed with a section 23 notice to implement this change once it has considered the responses it has received to the consultation on the NGC and Lattice merger. Please note that Ofgem's consultation on the merger is being undertaken separately from the section 23 consultation that has commenced today.

Conclusion

For the reasons described above and in the Second Notice, Ofgem has decided that it would be appropriate to re-consult on the proposed licence modifications described in Part A only of the Second Notice. This necessitates a revision in the timetables for the auctions. One consequence of this revision in timetable will be to give shippers more time to prepare their

strategies in respect of the long-term entry capacity auctions, if either modification proposal 0500 or modification proposal 0508 is implemented.

Transco has suggested that it may be useful that a seminar be held in September to enable shippers further to understand the regime going forward. We would be interested in shippers' views as to this suggestion.

If there are any questions then please call me on the number above, or call Mark Feather on 020 7901 7437.

Yours sincerely

Kyran Hanks
Director, Gas Trading Arrangements