

Modification proposal:	Uniform Network Code (UNC) UNC216/UNC216A: Introduction of an Additional Discretionary Release Mechanism for NTS Entry Capacity (UNC216) / Introduction of Additional Pay-as-Bid Auctions for NTS Entry Capacity (UNC216A)		
Decision:	The Authority ¹ directs that proposal UNC216 be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	22 August 2008	Implementation Date:	22 August 2008

Background to the modification proposal

Currently obligated entry capacity to the National Transmission System (NTS) is sold via a number of different products, these being quarterly system entry capacity, monthly system entry capacity, daily system entry capacity and daily interruptible entry capacity. These products are sold through various auctions: Quarterly System Entry Capacity (QSEC) auctions, Annual Monthly System Entry Capacity (AMSEC) auctions, Rolling Monthly Trade and Transfer System Entry Capacity (RMTTSEC) auctions, Daily System Entry Capacity (DSEC) auctions and Daily Interruptible System Entry Capacity (DISEC) auctions. Following the approval of UNC159³ National Grid Gas NTS (NGG NTS) also has the discretion to make available further amounts of interruptible entry capacity.

These auction arrangements provide a fixed set of opportunities and products through which shippers are able to buy access to the NTS entry capacity. However, the arrangements also set limits on how NTS entry capacity can be acquired and may discourage certain types of NTS users from accessing the NTS at a time when more flexible approaches of accessing the NTS may be required, for example, in order to encourage more diverse sources of gas.

NGG NTS has brought forward UNC216 to introduce more flexibility in the nature and scope of NTS entry capacity products. This proposal has attracted a variant proposal (UNC216A).

The modification proposals

Introduction of an Additional Discretionary Release Mechanism for NTS Entry Capacity (UNC216)

NGG NTS proposes to introduce an additional capacity release mechanism which would allow it to invite applications for quarterly, monthly, daily or daily interruptible entry capacity outside of the existing auction mechanisms. The timing of such invitations and the quantities of entry capacity offered would be at the sole discretion of NGG NTS. This would be mainly for discretionary entry capacity (in addition to baselines) but under certain circumstances may involve unsold obligated capacity.

The entry capacity offered by NGG NTS would be subject to the prevailing reserve price and be available for a period of no more than one capacity year.

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

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ UNC159: National Grid NTS discretionary release of interruptible NTS entry capacity

NGG NTS would make the terms and conditions for the release of the capacity available at least seven days before the actual release of that capacity. Two days before this discretionary entry capacity is available for use, NGG NTS will inform users of their capacity bids that have been accepted. One day before this discretionary entry capacity is available for use, NGG NTS will publish in the public domain summary information on the discretionary entry capacity to be released.

The proposer considers that UNC216 would better facilitate the following relevant objectives:

- The efficient and economic operation of the pipe-line system to which this licence relates
- So far is consistent with sub-paragraphs (a) to (c) the securing of effective competition (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers

Introduction of Additional Pay-as-Bid Auctions for NTS Entry Capacity (UNC216A)

E.ON UK proposes to introduce additional pay-as-bid auctions for entry capacity in strips of between one month and one year which will be held over a minimum of two rounds, with a reserve price being applicable.

NGG NTS would make the terms and conditions for the pay-as-bid auction available 28 days before the actual release of the capacity.

The release of information from the pay-as-bid auction to shippers and to the wider public would be the same as for UNC216.

This process would only be applicable until 30 September 2009 to minimise unforeseen consequences and to allow for a considered review of the process.

The proposer considers that UNC216A would better facilitate the following relevant objectives:

- The efficient and economic operation of the pipe-line system to which this licence relates
- So far is consistent with sub-paragraphs (a) to (c) the securing of effective competition (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers

UNC Panel⁴ recommendation

At the modification panel meeting held on 19 June 2008, of the 8 voting members present, capable of casting 9 votes, 9 votes were in favour of implementing UNC216 and 9 votes were in favour of implementing UNC216A. The Panel therefore recommended implementing both proposals.

⁴ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

At the same meeting the Panel cast votes on for the proposal which they considered would better facilitate the relevant objectives. Of the 8 voting members present, capable of casting 9 votes, 3 votes were cast in favour of implementing UNC216 in preference to UNC216A and 3 votes were cast in favour of implementing UNC216A in preference to UNC216. Therefore the Panel failed to determine which of the two proposals would better facilitate the achievement of the relevant objectives.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 29 July 2008. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR⁵. The Authority has concluded that:

- 1. implementation of the modification proposals UNC216 and UNC216A will better facilitate the achievement of the relevant objectives of the UNC⁶;**
- 2. of these proposals, UNC216 best meets the relevant objectives of the UNC; and**
- 3. directing that the modification UNC216 be made is consistent with the Authority's principal objective and statutory duties⁷.**

Reasons for the Authority's decision

The efficient and economic operation of the pipe-line system to which this licence relates

The majority of respondents welcomed the release of additional entry capacity arising from the two proposals, which would encourage a more liquid market for NTS entry capacity. One respondent stated that system inefficiencies result from the failure to recognise that different entry points use entry capacity in different ways and so greater flexibility is required in the current arrangements for releasing capacity.

Some respondents favoured UNC216 as they considered that it has less restrictions on product length, less complexity (through not having a two-round auction) and less time to release entry capacity. However, several opposed its implementation as they considered that it provided too much discretion to NGG NTS in the nature of the product it introduced and that the availability of such capacity could undermine the value of capacity obtained in the regular auctions.

Ofgem considers that both proposals should provide the flexibility for NGG NTS to offer entry capacity products on shorter term timescales, where the capacity is available. We consider that this should help to optimise the use of NTS entry capacity and should therefore better facilitate the efficient and economic operation of the NTS.

We consider that UNC216 - with less restrictions on the duration of the entry capacity products, the notification period and application process - provides greater flexibility than

⁵ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁶ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

⁷The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

UNC216A. This could result in greater amounts of entry capacity being made available under UNC216 and result in it better facilitating the efficient operation of the NTS.

So far is consistent with sub-paragraphs (a) to (c) the securing of effective competition (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers

A number of respondents raised concerns with both proposals over the degree of NGG NTS's discretion and the overall lack of transparency surrounding the capacity release mechanisms, especially in the case of UNC216. Some thought the lack of transparency in UNC216 could lead to an approximation of bi-lateral deals and the provision of a knowledge advantage to the parties whose original request had initiated the release of the additional capacity.

There was debate amongst the respondents regarding the notification period for employment of the capacity allocation mechanisms. Some considered that 28 days may be too long and would not allow exploitation of short term opportunities and efficient provision of entry capacity, while others considered that the ability to introduce potentially significant quantities of entry capacity at just seven days notice might have a destabilising impact on the market.

We think that the minimum seven days advance notification is sufficient time in which NTS users can react to an invitation for additional entry capacity release. We do not believe that the shorter timescales proposed by UNC216 for the introduction of entry capacity will cause instability in the market. We would also expect that in general, the quantity of capacity that NGG NTS could make available to the market through this mechanism would be small in comparison to the overall system capacity; the levels of capacity variability should be commensurate with those that exist under current systems and so should not have a destabilising effect on prices. Any significant quantity of capacity (eg the 10mcm NGG NTS expects to be available at Easington for this coming winter) is likely to be signalled well in advance and so should not come as a surprise to the market. It is also important to note that NGG NTS already offers discretionary short term NTS entry capacity products for sale including daily firm and interruptible entry capacity. Rather than producing instability, the release of these products is important in providing flexibility to shippers seeking NTS entry capacity in the short term and also to help fine tune their capacity positions.

Additionally, standard special condition A6 (Conduct of Transportation Business) of NGG NTS's gas transporter licence requires that NGG NTS conducts its business such that there is no unfair commercial advantage secured by any of the following: NGG NTS or its affiliates and related undertakings, any gas shipper or supplier or any distribution network operator. We would therefore expect NGG NTS to ensure that the design of these arrangements does not result in inappropriate market implications. In this context, we note that NGG NTS is aware of the concerns expressed by respondents and has proposed to undertake a review of each capacity release that might be undertaken if UNC216 is approved and also to conduct an annual review on the whole process; Ofgem welcomes this proposal.

We note the concerns respondents raised with transparency regarding the two proposals but that despite these concerns the proposals received support from the majority of respondents and panel members. We think that improved transparency is possible and would work in the interests of shippers and consumers. We would encourage NGG NTS

to work with shippers in devising a suitably transparent process whilst maintaining the flexibility benefits; for example, NGG NTS could publicise that it has been approached to hold such additional discretionary releases as soon as it can without breaching confidentiality issues with the requesting party, rather than waiting for the point at which the invitation process is initiated, as is the case in the current description of UNC216.

Ofgem is of the view that implementing UNC216 is also preferable to UNC216A due to the shorter notification period, and fewer restrictions on the duration of the NTS entry products on offer. This greater flexibility will allow more types of NTS user, whose use of the NTS varies, to be able to access NTS entry capacity. The introduction of more flexible arrangements for shippers to purchase NTS entry capacity should help users, across a diverse range of business models, to access this capacity when they need it and therefore should better facilitate the securing of effective competition between shippers. We consider that UNC216A, by restricting the notice period and the nature of the products on offer would reduce the benefits of the modification and reduce the level of flexibility available to users, who may need to seek access at short notice.

We would note that some concerns have been raised regarding the nature of the capacity release mechanism that would be utilised under proposals UNC216 and UNC216A. Based on the legal text of the modification proposal that has been submitted to the Authority, it is Ofgem's understanding and expectation that capacity will be offered via a pay-as-bid auction. If the additional discretionary release mechanism for NTS entry capacity under UNC216 turns out not to be conducted by auctions then we would look for this to be dealt with through the raising of a UNC modification proposal to correct this on an urgent basis.

So far is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code

Some respondents did not agree with having an end date for UNC216A, whilst others considered this an advantage in that it facilitates a solution to near term capacity issues whilst not distorting long term mechanisms. We recognise the intent of allowing a review prior to full implementation has certain merits but consider that the enduring nature of the mechanism proposed by UNC216 is more efficient from an administrative point of view.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal *UNC 216: Introduction of an Additional Discretionary Release Mechanism for NTS Entry Capacity* be made.



Stuart Cook

Director, Transmission

Signed on behalf of the Authority and authorised for that purpose.