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Dear Mark

UNC Modification Proposals 0036 and 0043 – Limitation on offering for sale unsold capacity

I refer to the two letters issued by Ofgem on 25 August 2005 regarding the two proposals to the UNC raised by Transco NTS in relation to entry capacity auctions. UNC0043 proposes to allow Transco NTS to have the discretion to refuse to offer baseline and obligated incremental capacity for sale through auctions under described circumstances. UNC0036 proposes to allow Transco NTS to have flexibility in specifying lead times for the delivery of incremental capacity allocated in LT auctions.

SGD set out the reasons for not supporting implementation in its response on UNC0043. Having studied Ofgem's letter of 25 August 2005 and later addendum on UNC0043, and given our understanding of discussions at the Transmission Workstream on 1 September 2005, our position is unchanged.

Ofgem's Letters

We understand from the Addendum that the proposal by Transco NTS would affect *any* capacity released in auctions up to 31 April 2007. This only reinforces our concerns regarding the current level of uncertainty associated with the entry capacity auctions. We note that Ofgem when it made its decision to implement this regime stated that the introduction of the long term entry regime would "significantly reduce an existing element of contractual risk for producers [shippers]".¹ The original concept of long term arrangements had support in the industry as a way of providing certainty for upstream investment decisions. It is important to ensure that the regime reduces risk to ensure investment for long term security of supply.

Ofgem states that there can be circumstances where Transco is offering for sale capacity it cannot deliver for reasons beyond its control. Given this, it is clear that the approach adopted when the 2002-07 incentives were put in place were flawed as it

¹ "Transco Price Control and SO incentivise 2002-7 – Licence modifications and way forward." Letter from Dr E Marshall to industry participants, 27 September 2002

now considered necessary to introduce major changes to them through licence changes. We have been concerned that the licence arrangements would undermine the aim of reduced uncertainty and risk. SGD wrote to the Authority in September 2002 outlining our concern that these arrangements “will be determined by private discussions between Transco and Ofgem” but we were told that the complexity of the arrangements were justified as being “robust, sufficiently flexible to accommodate possible changes to the regime in future and accurately determine the incentive revenues in a manner that minimises the possibility for dispute.”² We must note that Transco accepted these licence proposals and the risks to Transco that it entailed. It now appear that Transco wishes to reduce and/or pass on its regulatory and contractual risks which are now know to arise from this regime. Transco NTS’s note on potential lead times circulated on 5 September 2005 does not provide much explanation. The 1999 Environmental Impact Assessment Regulations were known at the time the price control was agreed and it was Transco’s decision to accept it knowing that these regulations were in place and could have an impact.

Response on issues raised

We agree with Ofgem that Transco NTS’s proposal should have been raised much earlier. We consider it unfortunate that Transco NTS did not raise this as a workstream topic and/or normal proposal much earlier in the year. We assume that this proposal does not relate to Ofgem’s UCA discussions and, as such, see little justification for Transco NTS’s approach.

We commend the Authority’s decision to implement UNC0030. However, given the delay we are disappointed that Ofgem did not participate in discussions with the industry on the issues raised but instead has relied on these letters to communicate its views. Earlier discussion by Transco NTS and Ofgem at workstream meetings would be likely to have resulted in a more satisfactory outcome.

The proposed consent mechanism does not provide us with much comfort regarding the arrangements. Although the intention is to consult with the industry, we have concerns relating to the amount of transparency this will provide will be provided. The note circulated by Transco NTS referred to above is not very detailed. Additional consultation by Ofgem only adds to the level of administrative and regulatory activities relating the LT auction processes.

If Ofgem does implement this proposal, we consider that a licence amendment will be required. We are concerned about timing and if this approach is adopted, it would suggest that consultation would need to commence very soon to ensure that even the November deadline could be met. As such, it raises issues about process and involvement of the industry to date. For Ofgem to conduct an approval process before the next round of LT auctions would imply that these would need to be complete by the end of October before Transco NTS sent out its formal invitation to auction, ten days before the start of the auctions. The last day the auctions could commence is 17 November although they have usually started on Mondays to cover two full working weeks. If an acceptance letter is issued, it should be accompanied by a detailed timetable leading up to the auctions.

Ofgem’s letter states that this proposal is unlikely that UNC 0043 will have the effect of securing effective competition between shippers and suppliers but that any detrimental

² Dr Marshall letter quoted above, 27 September 2002

effect will be limited to the capacity release from April 2007 to March 2008. However, as the Addendum letter of 26 August 2005 makes clear, the impact will be somewhat broader than this making the impact on competition more significant. As such, the Authority should reject this proposal as it does not further the Relevant Objectives.

Yours sincerely

Tanya Morrison
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