



Transco NTS and other interested parties

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Dear Colleague,

**Proposed amendment to the Incremental Entry Capacity Release (IECR) Methodology Statement to introduce a formal consent process to adjust investment lead times**

Ofgem<sup>1</sup> has considered the issues raised in the consultation report submitted by Transco National Transmission System (NTS) on 3 October 2005 in respect of its proposed revisions to the IECR Methodology Statement. Having regard to the principal objective and statutory duties of the Authority<sup>2</sup>, and for the reasons set out in Ofgem's Way Forward open letter<sup>3</sup> and this letter, Ofgem has decided that it will not be directing that the proposed revisions should not be made pursuant to Special Condition C15(6)(iii) of the Transco NTS Gas Transporter's licence within the 28 day period allowed by Special Condition C15(6)(ii).

This letter outlines the background to the Transco NTS consultation and gives the reasons for the decision.

**Background to the consultation<sup>4</sup>**

On 18 July 2005 Transco NTS raised urgent modification proposal 0036 '*Limitation on incremental capacity offered in QSEC auctions*'. This modification proposal would provide Transco NTS with a degree of flexibility to specify revised lead times for the delivery of any incremental capacity that is allocated in the long term auctions. Transco NTS stated that the proposal would have the advantage of ensuring consistency between the UNC and the relevant provisions of the IECR, in particular the change made in July 2005 allowing Transco NTS to specify a longer lead time than three years under certain circumstances.

*Modification proposal 0036 – Ofgem Initial views letter*

<sup>1</sup> Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably in this letter.

<sup>2</sup> Set out in Section 4AA of the Gas Act 1986, as amended.

<sup>3</sup> 201/05 - *Modification proposals 0036 and 0043 - way forward*, Ofgem, September 2005 ('way forward letter').

<sup>4</sup> For a more detailed description of the background to the consultation, please refer to the initial views letter and the way forward letter.

On 25 August 2005 Ofgem issued a letter for consultation providing its initial views on Modification Proposal 0036 (the 'initial views' letter). In this letter Ofgem stated that, without fettering the Authority's discretion with respect to Modification Proposal 0036, its initial view was that the proposal should be approved. However, Ofgem had some concerns relating to the degree of discretion that both the proposal and the latest version of the IECR provided Transco NTS with respect to extending the lead times associated with the provision of incremental capacity. Ofgem's initial view was that there would be merit in proposing modifications to Transco's NTS GT licence, or for Transco NTS to propose modifications to its IECR, to incorporate a formal process through which Transco NTS would require the Authority's consent before it would be able to adjust the lead times for the provision of incremental entry capacity. In addition, Ofgem's initial view was that, in the event that Transco NTS wishes to extend the lead times for the delivery of incremental capacity, it would be preferable for Transco NTS to notify industry participants of the proposed change in advance of the long term auctions.

#### *Ofgem Way Forward letter*

On 13 September 2005, following consideration of responses to the initial views letter, Ofgem issued a letter setting out its further views on this proposal and a way forward<sup>5</sup> (the 'way forward' letter).<sup>6</sup> In this letter Ofgem reiterated its views on Modification Proposal 0036 and stated that it would be preferable for the formal consent process to be incorporated within the framework of the IECR statement, as it is the IECR which governs the process by which Transco NTS determines whether to release incremental entry capacity.

On 13 September 2005, the Authority also issued a letter providing Transco NTS with consent to a shortened, 14 day, consultation period with respect to the proposed IECR Methodology Statement revisions, pursuant to Special Condition C15(5) of the Transco NTS GT licence.

#### *Transco NTS IECR consultation*

On 14 September 2005 Transco initiated a consultation proposing a number of revisions to the IECR Methodology Statement to include a requirement for Transco NTS to:

- ◆ obtain the written consent of the Authority to adjust the lead time for all or part of the incremental capacity to be released at an ASEP; and
- ◆ consult the industry in advance of making any such application to the Authority.

On 21 September 2005 Transco NTS also issued a document which consulted industry participants on a potential change in investment lead times at two entry terminals (Easington and Milford Haven), should the proposed revisions to the IECR Methodology Statement take effect. This consultation will close on 5 October 2005 and Transco NTS is expected to deliver a report on this consultation and a formal submission to the Authority requesting consents to revise lead times under the IECR.

#### **Respondents' views**

Transco NTS received four responses to its consultation, none of which were marked as

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<sup>5</sup> This letter also set out Ofgem's views on modification proposal 0043 'Limitation on offering for sale unsold capacity'

<sup>6</sup> Electronic versions of the letters can be found on Ofgem's website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)) under the 'Gas Governance' area of work.

confidential.

One respondent welcomed the inclusion of an industry review process into the IECR Methodology Statement, allowing the industry to make representations on applications made by Transco NTS to the Authority when wishing to revise its lead times for incremental capacity release. However, this respondent stated that the consultation report sent to Ofgem by Transco NTS should be published as part of the process.

Another respondent agreed that the requirement to obtain consent should be codified within the IECR Methodology Statement, but stated that they did not believe that the amendment proposed contained sufficient detail to capture the obligations which should be placed upon the Transporter in seeking consent and therefore did not support the proposed revision.

Another respondent agreed that the proposed amendments met the requirements to introduce a formal consent process to adjust investment lead times into the IECR Methodology Statement. However, this respondent stated that the period for representations should be 28 days rather than 14 days, and that the IECR Methodology Statement should set out the types of issues that may be considered as part of any consultation. This respondent also suggested some redrafting to aid clarity.

Another respondent welcomed the introduction of a formal consent process but expressed concern in relation to the “fast track” timetable adopted. This respondent queried whether 14 days was a sufficient period for Transco NTS consultations in relation to future applications and suggested a period of 28 days instead. This respondent also expressed concern that the IECR Methodology Statement is silent with respect to the types of information that Transco NTS should provide within such a consultation.

### **Ofgem’s view**

On 3 October 2005, following the close of Transco NTS’s consultation on the proposed changes to the IECR Methodology Statement, Transco NTS submitted a consultation report to Ofgem consistent with the provisions of Special Condition C15(5)(iii). Ofgem notes that the revised statement provided has been amended following consideration of concerns raised by shippers in Transco NTS’s consultation process.

Ofgem considers that there may be limited circumstances where it is necessary for Transco’s NTS business to have the ability to extend investment lead times and therefore lead times for the delivery of incremental capacity, to take account of factors that are beyond its control.

However, whilst there may be good reasons for granting Transco NTS this flexibility, this discretion could also be used to delay the delivery of incremental capacity on account of poor planning or project management on the part of Transco NTS. In this case, the granting of a broad discretion may undermine the incentives that have been placed on Transco NTS. In particular, if Transco NTS fails to deliver capacity for reasons that are within its control then it should face exposure under its buy back incentive scheme.

Further, it is also important to note that there are costs associated with any failure on the part of Transco NTS to deliver timely and efficient investment solutions in response to market signals. These costs may manifest themselves in higher auction prices to the extent that demand for entry

capacity exceeds what can be physically supplied or higher gas prices to the extent that shippers cannot bring their gas to market.

As a consequence, Ofgem considers that it is important that any exercise of this discretion is subject to the Authority's consent to prevent Transco NTS from inappropriately using this discretion to avoid exposure to buy back costs under its incentives. Ofgem therefore agrees that the proposed revisions to the IECR Methodology Statement are necessary to limit the discretion of Transco NTS in adjusting investment lead times by requiring Authority consent.

Ofgem also considers that the revisions introduce transparency by ensuring that Transco NTS must consult on any applications it makes to the Authority to adjust investment lead times. As noted in the way forward letter, Ofgem considers that it is important that there is transparency surrounding any consent process such that industry participants are aware of which terminals and for what periods Transco NTS would wish to adjust investment lead times. Ofgem also believes that it is important that shippers and other industry participants should be able to provide input, through the consultation process, to any decision that Transco NTS may wish to take to adjust lead times.

Ofgem notes the concerns raised by respondents regarding the time period associated with consultations on any applications for consent to adjust lead times. Ofgem notes in this respect that the drafting of the IECR has been adjusted to specify that the consultation period is for a minimum of 14 days unless the Authority otherwise consents.

Ofgem considers that this is sufficiently flexible to allow consultation periods of greater than 14 days where this is possible given auction timetables. In this respect, Ofgem would encourage Transco NTS to ensure that it brings forward any applications it may wish to make in a timely manner and well before the annual long term auctions to facilitate consultation periods of greater than 14 days where possible.

### **Ofgem's decision**

Following consideration of the documentation provided (including responses to Transco NTS's consultation) and having regard to the Authority's principal objective and statutory duties and for the reasons set out above, Ofgem has decided that it will not be directing that the proposed revisions should not be made pursuant to Special Condition C15(6)(iii) within the 28 day period allowed by Special Condition C15(6)(ii).

Ofgem would however note that whilst it has not elected to veto these revisions, it is important to note that there will be a more formal review of investment lead time issues in the context of the forthcoming NTS price control review process. Such a review would consider whether a formal consent process should be used in the longer term in response to Transco NTS proposals to adjust lead times or whether an alternative process such as dispute resolution is a valid alternative.

This letter does not fetter the discretion of the Authority with regards to the Transco NTS consultation that is currently underway to adjust investment lead times in respect of the release of incremental capacity in the 2005 QSEC auction and any subsequent formal application from Transco NTS to the Authority in this regard.

If you wish to discuss any aspect of this letter, Mark Feather (telephone 0207 901 7437) or Matteo Guarnerio (telephone 0207 901 7493) would be pleased to assist.

Yours sincerely

Robert Hull  
**Director, Transmission**