Final Modification Report
Modification Reference Number 0393
Disposal of Operating Margins/Top-up Gas

This draft Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal:

When, at the commencement of a Storage Year, the inventory of Operating Margins Gas (OM) or Top-Up Gas (TV) is greater than the storage space held by Transco for that purpose, under the Network Code Transco has an obligation to dispose of that surplus.

At present under the Network Code, the surplus under one account (ie OM or TV) has to be transferred to the other account if the receiving account has a deficit. Such transfers take place at the Weighted Average Cost of Gas (W ACOG) of the disposing account which may not necessarily be the most economically advantageous method of procuring gas to make up the deficit.

Where, taking OM and TV together, there is a surplus in aggregate, Transco has an obligation under the Network Code to dispose of this surplus by Tender "as soon as reasonably practicable after the start of the Storage Year" Network Code Section K 3.3.2

This Modification Proposal seeks to

- Remove the obligation on Transco to transfer storage gas surpluses between the OM and TV accounts,
- Permit disposal of a surplus in OM and/or TV gas prior to the commencement of the following Storage Year,

but retain,

- At Transco's discretion the right to dispose of surplus gas and the right to procure gas to meet any deficits which may exist on both storage accounts in a joint tender if this could benefit both the OM and TU accounts and the community as a whole.

2. Transco's opinion:

Transco believes the rules which exist in the Network Code concerning disposal of residual surplus gas from either the Top-up or Operating Margins account are no longer appropriate given that the costs of each account are no longer borne by the same party. Following the implementation of Modification Proposal 0297 Transco now incurs all costs associated with Top-up; Shippers face the gas costs of Operating Margins. If either the OM or Top-up account is in surplus and the other is in deficit the current obligation is to transfer gas between the two accounts at the W ACOG of the transferor account. This means that the account which is in deficit will have different costs than if gas is procured from the market to make up the deficit.

Conversely the account with a surplus would be expected to receive a different revenue than if the surplus in that account was disposed of via the market or tender. Transco believes that if this surplus and deficit scenario exists then there will always be one account which is financially advantaged and the other which is financially disadvantaged i.e. one loser and one winner; Shippers or Transco could lose one year and maybe benefit the next. As such the obligation to transfer between the two accounts should be removed and the surplus or deficit existing on either account should be solved by buying and selling gas on each account individually.

Transco has to purchase the following year's storage capacity for both OM and Top-up well before the start of that Storage Year. Transco knows the OM and Top-up requirement prior to the start of the Storage Year and whether or not a surplus or deficit will exist on the OM and Top-up accounts. Current rules in the Network Code only permit Transco to dispose of any surplus or make up any deficit after the beginning of the Storage Year. Disposing of surpluses earlier could lead to higher revenues. Current differentials from April and May are 0.5p/theml in favour of an April disposal. Transco believes these higher revenues would reduce Shippers net gas cost exposure on the OM account and recommend that earlier disposal of surplus gas should be allowed. Where a deficit exists on either the OM or Top-up account then an early purchase of gas would not be in the interests of Shippers or Transco as the available indicators suggest gas prices in April 2000 are likely to be higher than in May.

Transco believes there are benefits in economies of scale when purchasing or disposing of gas. Therefore, where the Top-up account and the OM account are in deficit or both in surplus, then Transco should be able to procure and sell gas for both accounts in a joint tender.

Transco also believes that the current rules preventing an early disposal of surplus gas could lead to Transco incurring unnecessary space and deliverability overrun charges should a surplus exist at the end of the Storage Year and the Storage Operator of a Storage Facility, in which Transco has gas and a capacity booking, decides to levy overrun charges from 1 May onwards.

3. Extent to which the proposed modification would better facilitate the relevant objectives:

This Modification Proposal would better facilitate the economic and efficient operation by Transco of its pipeline system as outlined in Standard Condition 7(1)(a) by ensuring that the costs incurred in respect of providing OM and Top-up are efficiently incurred with charges reflective of prevailing market prices.

4. The implications for Transco of implementing the Modification Proposal, including:

a) implications for the operation of the System:
There are no implications for the operation of the system which would result from the implementation of this Modification Proposal.

b) development and capital cost and 0perating cost implications:
No development or capital costs have been identified which would result from implementation of this Modification Proposal. Transco has identified that if the Top-up account is in deficit with the OM account in surplus then Transco will, if this Modification Proposal is implemented, not incur unnecessary costs from gas transfers at the W ACOG of the OM account.

Transco would also avoid unnecessary overrun charges should this Modification Proposal be implemented.

c) extent to which it is a appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:
Not applicable

d) analysis of the consequences (if any) this proposal would have on price regulation:
There would be no consequential impact on price regulation that would result from the implementation of this Modification Proposal

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal:
If implemented this Modification Proposal would reduce the level of contractual risk faced by Transco under the Network Code as any Top-up costs incurred will be more reflective of market prices.

6. The development implications and other implications for computer svstems of Transco and related computer systems of Users:
No development implications for Transco's or Users computer systems have been identified which would result from the implementation of this Modification Proposal.

7. The implications of implementing the Modification Proposal for Users:
Transco would be able to dispose of surplus OM gas earlier that at present if the price likely to be achieved benefits Users. If a deficit on the OM account exists then implementation of this Modification Proposal will prevent a compulsory transfer of gas from the Top-up account at the W ACOG of the Top-up account which is likely to be higher than the prevailing market price. In both cases Shippers exposure to net OM gas costs would be reduced as a result of implementation of this Modification Proposal.

The discretion allowed for joint procurement for both the OM and Top-up accounts should lead to economies of scale of purchase with prices closer to those prevailing in the market if this Modification Proposal is implemented.

8. **The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Storage Operators, suppliers, producers and, any Non-Network Code Party:**

Transco has not identified any other implications for these groups which would result from implementation of this Modification Proposal.

9. **Consequences on the legislative and regulatorv obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal:**

No consequential effects on the legislative and regulatory obligations and contractual relationships of Trans co, each User and Non-Network Code Parties have been identified associated with implementation of this Modification Proposal.

10. **Analysis of any advantages or disadvantages of implementation of the Modification Proposal:**

Advantages:

- Removal of the obligation to transfer gas between the Top-up and Operating Margins accounts will remove the resultant "winner" and "loser" situation which occurs when one account is in deficit and the other is in surplus.
- Allowing early disposal of surplus gas from either account is likely to result in increased revenues which will reduce the net cost for users.
- Joint procurement would allow economies of scale to potentially achieve a lower unit gas price than otherwise would be the case.

Disadvantages:

- Depending on the surplus quantities involved early disposal could affect general prices in the market. However, disposal of surpluses using a range of delivery periods and transfers in store could be used to reduce any impact on the market.

11. **Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report):**

Representations were received from Total Gas Marketing, Dynegy and British Gas Trading Ltd (BGT). All organisations that responded supported this Modification Proposal.

BGT made three comments in respect of the legal drafting. BGT commented that the legal drafting gives Transco the flexibility to make early disposals but still gives the flexibility to make disposals after the start of the Storage Year. BGT asked for the drafting to be explicit in requiring Transco to delay disposal if the following two conditions are satisfied:-

"i) Transco (who bear storage capacity charges) can be assured that any overrun charges will be zero (either contractually or by being waived), and also

ii) Transco believe that a delay is more likely to result in an increase in the proceeds from disposal of the gas (these proceeds being shippers' rather than Transco's) than a decrease, which is seldom likely to be the case."

Transco agrees with BGT that the legal drafting as drafted allows for the flexibility indicated above. Transco would propose to use the flexibility in pursuit of compliance with the relevant objectives of its PGT Licence, in particular Standard Condition 7(1)(a) "the efficient and economic operation of its pipeline system". Transco believes further drafting in this area is not required and as such no amendments to the legal drafting in respect of BGT's comments have been proposed in this report.

BGT has recommended that the legal drafting be specific in allowing gas swaps between facilities as an option in resolving the disposal of residual surplus gas.

Transco welcomes BGT's comments and has amended paragraph K3.1.3 of the proposed legal text in a manner which Transco believes satisfies BGT's aspirations.

BGT also commented that an addition to the legal text is required to ensure that "where surplus gas is addressed by withdrawals, these withdrawals should be at constant daily rate over as many days as is practicable".

Transco believes the last of BGT's suggested amendments to the legal text adds no further improvement. Transco believes that complying with the relevant objectives of its PGT Licence will result in Transco disposing of surplus gas in the most economic and efficient manner possible and this will determine the number of days over which it is practicable to withdraw surplus gas.

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation:

This Modification Proposal is not required to facilitate compliance with safety or other legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:

There would be no change to the methodology established under Standard Condition 3(5) of the licence as a result of implementing this Modification Proposal.

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

- Establish the quantity of any surplus or deficit on the Top-up and Operating Margins accounts
- Prepare a tender for the disposal and/or procurement of gas for the Operating Margins and Top-up accounts

15. Proposed implementation timetable (inc timetable for any necessary information systems changes):

Establish quantities for disposal or procurement and prepare tenders by early April.

Modification Proposal implemented with effect from 06:00 14 April 2000

16. Recommendation concerning the implementation of the Modification Proposal:

Transco recommends that this Modification Proposal should be implemented

17. Restricted Trade Practices Act:

If implemented this proposal will constitute and amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal:

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Director General in accordance with this report.

19. <u>Text:</u>

Proposed legal text

SECTION K: OPERATING MARGINS

Rename paragraph 3.1 *'Storage Capacity and pre-Storage Year transfers' and add paragraphs* 3.1.2, 3.1.3 *and* 3.1.4 *to read as follows:*

"3.1.2 Following 1 February in a Storage Year, Transco may, in respect of each Storage Facility, estimate:

(a) the Relevant Residual Gas that will be held by each Relevant System Manager at the end of the Storage Year (the **"estimated Relevant Residual Gas"**);

(b) the amount (if any) (the **"pre-Storage Year estimated surplus")** by which the estimated Relevant Residual Gas of a Relevant System Manager (the **"pre-Storage Year transferor")** exceeds the amount of Storage Space that Transco estimates will be held for the following Storage Year in that Storage Facility by the Relevant System Manager.

3.1.3 In respect of a Storage Facility where there exists a pre-Storage Year estimated surplus, Transco may on behalf of a pre-Storage Year transferor seek to make a transfer in favour of a User(s) in respect of the pre-Storage Year estimated surplus before the end of the Storage Year by way of:

(a) Storage Gas Transfer(s): or

(b) Storage Gas Transfer(s) between relevant Storage Facilities; or

(c) withdrawal from a relevant Storage Facility and Trade Nominations in respect of the quantity of gas withdrawn

by conducting a tender or a series of tenders.

3.1.4 For the purposes of a tender referred to in paragraph 3.1.3, the provisions of paragraph 3.3.2(a) to (h) shall apply as if the references therein to Residual Surplus Gas were references to the pre-Storage Year estimated surplus, as if references to Residual Gas Transfer were references to a transfer under paragraph 3.1.3 and as if the reference at paragraph 3.3.2(f)(ii) to paragraph 3.3.7 did not apply."

Amend paragraph 3.2.2 *to read as follows:*

"Subject to the relevant Storage Terms, a transferor may effect from the start of the Storage Year……".

Amend paragraph 3.3. *1 to read* as *follows:*

"…under paragraphs 3.2 and/or 3.2 exceeds the Storage Space held by…….", Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

Date: 12/04/2000

<u>Director General of Gas Supply Response:</u>

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transportcrs' Licence dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0393**, version **1.0** dated **12/04/2000** be made as a modification to the Network Code.

Signed for and on behalf of the Director General of Gas Supply.

Signature:

The Network Code is hereby modified, with effect from 14 April 2000, in accordance with the proposal as set out in this Modification Report, version 1.0

Signature:

Process Manager – Network Code
Transco

Date: 14/4/2000

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA "), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:

   (i) if a copy of the Agreement is not provided to the Director General of Gas Supply ("the Director") within 28 days of the date on which the Agreement is made; or

   (ii) if, within 28 days of the provision of the copy, the Director gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

   provided that if the Director does not so approve the Agreement then Clause 3 shall apply.

2. If the Director does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.

3. If the Director does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Of gem any provision (or provisions) contained in this Agreement by virtue of which the R TP A, had it not been repealed. would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Director would not exercise his right to give notice pursuant to paragraph 1 (5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Director pursuant to Clause 1 (i) above for approval in accordance with the terms of the Order.

4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1 (I) to (4) in the Schedule to the Order applies.