

DRAFT MODIFICATION REPORT

MODIFICATION REFERENCE 0077

This modification report is made pursuant to Rule 8.12 of the Modification Rules and follows the format required under Rule 8.12.4.

1. The Modification Proposal;

Change Charging Methodology for Hornsea Price Tender

2. TransCos opinion;

TransCo considers that the existing provisions of the Network Code are satisfactory.

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

TransCo should not discriminate between customers.

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

4.1 implications for the operation of System and any BG Storage Facility;

None

4.2 development and capital cost and operating cost implications;

None

4.3 extent to which it is appropriate for TransCo to recover the costs, and proposal for the most appropriate way for TransCo to recover the costs;

Not Applicable.

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;

None identified

6. The development implications and other implications for computer systems of TransCo and related computer systems of Relevant Shippers;

None.

7. The implications of implementing the modification for Relevant Shippers,

7.1 Administrative and operational implications.

None identified

7.2 Development and Capital cost and operating cost implications

All successful bidders in the price tender process will pay the same price for the service they have tendered for.

7.3 consequences (if any) of implementing the Modification Proposal on the level of contractual risk of Relevant Shippers under the Network Code as modified by the proposal.

None Identified

8. The implications of implementing of the modification for terminal operators, suppliers, producers and, any Non-Network Code Party;

None that workgroup is aware of.

9. Consequences on the legislative and regulatory obligations and contractual relationships of TransCo and each Relevant Shipper and Non-Network Code Party (if any), of the implementation of the Modification Proposal;

None that workgroup is aware of.

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

10.1 Advantages:

All successful bidders will pay the same price for the service they have tendered for.

10.2 Disadvantages:

10.2.1 The overriding view of shippers at the workgroup was that they saw little justification for the proposed modification. They were satisfied with the price tender process as written in the Network Code. They see price tendering, where products or services are sold to the highest bidder at the price bid, as a standard commercial practice.

Other concerns were:

10.2.2 The modification proposal does not include any change to the treatment of previous year users with preemption rights. Some shippers felt that this created opportunities for gaming.

One solution suggested was that the price at which services are offered to previous year users be capped. A cap of 102% of the lowest accepted bid price (the market clearing price) was suggested.

10.2.3 It was further suggested that the objective of ensuring that all shippers paid the same price for the same service could also be met by allocating capacity on a non price invitation basis (as Section R3.4 of Network Code)

11. Summary of the representations (to the extent that the import of those representations are not reflected elsewhere in the modification report);

One representation has been received at the time of writing. (Attached)

TransCo's responses to shipper concerns expressed at the workgroup meeting are given below:

11.1 TransCo are sympathetic to shippers views that the price tender process as written in Section R3.5 of the Network Code does not need to be changed. TransCo takes the view that the price tender process is not discriminatory as all shippers have the same opportunity to bid on the basis of information available to them. However the Regulator has suggested that the process should be reviewed as it results in Shippers paying different prices for the same service, and that it should be changed. Ofgas have supplied a short note explaining their view, which is attached to this report.

11.2 TransCo accepts the shippers view that gaming bids might be possible, although it feels that it is highly unlikely. If there was any evidence of gaming bids then the high weighted average price calculation could, in consultation with the Regulator, be performed with those bids excluded.

11.2 TransCo does not believe that the gaming remedy suggested by some shippers is desirable,

and it may be inappropriate to set the differential between clearing price and high weighted average price in advance of the bidding process. The suggested capping level of 102% places narrow constraints on the different values which Users might legitimately place on the Hornsea service, and places too low a premium on the preferential booking rights which such Users are actually taking advantage of.

As an example, based on a full cycle of Hornsea at 13.0 p/th a 102% cap represents a premium of only 0.26 p/th.

Should it be felt that a cap is essential, then TransCo would suggest that it should be around 110%, representing a premium of about 1.3p/th.

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

Not applicable

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

Not applicable

14. Programme of works required as a consequence of the implementation of the Modification Proposal;

None

15. Proposed implementation timetable;

A decision needs to be made by early February 1997, to enable TransCo Storage to incorporate appropriate advice to Users in the 1997 Annual Storage Invitation.

16. Recommendation for the implementation of the modification;

Taking into account the strongly held views expressed by Shippers at the Development Workgroup meeting, TransCo recommends that the proposal as submitted is NOT implemented, ie no change to existing Network Code text is required.

17. TransCo Proposal

This Modification Report contains TransCos proposal **not** to modify the Network Code and TransCo now seeks the agreement of the Director General in accordance with this report.

18. Text provided pursuant to Rule 8.14

No change to the existing text is recommended.

Signed for and on behalf of British Gas TransCo.

Signature: *Irene Davies*
Date: *4th November 1996*
Name: *IRENE DAVIES*
Position: *COMMERCIAL EXECUTIVE - TRANS CO STORAGE*

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|---------|-----------------------|--|
| To | Richard Gray |  Post-it Fax Note Ref No: 7698 |
| Company | BRITISH GAS TRANS CO. | |
| From | Colin Dickens | |
| Company | MOBIL GAS | |
| Tel No. | 0171 412 4758 | No. of Pages: 1 |

1 November 1996

Dear Richard,

Modification 0077 - Terms of Reference

Mobil fully support the creation of a Work Group to address the above Modification entitled "Change Hornsea Price Tender Charging Methodology".

Yours sincerely,



Colin Dickens
Manager, Network Code & Systems

APPENDIX TO DRAFT MODIFICATION REPORT 0077

VIEW PROVIDED BY OFGAS

TransCo is obliged to price each of its services in a non-discriminatory way. This obligation includes TransCo's storage services such as the Hornsea Salt Cavity. The Network Code defines a price tender process for Storage Services. Under the procedure currently in the Code, each successful bidder pays the price it bid. In advance of the last invitation to tender (issued in March 1996), Ofgas expressed concern that this way of conducting the tender results in discriminatory pricing because customers receive the same service (from a monopoly) but pay different prices. At Ofgas' suggestion, TransCo revised the tendering procedure such that capacity was allocated on the basis of the bid price, but all successful bidders paid the lowest accepted bid (the market clearing price).

In August 1996, Ofgas published a consultation document on TransCo's Storage Business. Among other issues, views were requested on whether TransCo Storage operates in a competitive market. The respondents, with the exception of TransCo, were generally of the view that there is only limited competition, and only for some of TransCo's storage services. The views of the respondents indicate that there is broad support for provisions which protect customers and foster the development of storage competition. At a minimum, it would appear necessary to ensure that TransCo Storage does not engage in price discrimination for its services and there was general support for this among the respondents.

TransCo has now proposed that the Network Code be revised to adopt the approach used in the last tender. In light of TransCo's obligation not to discriminate in its pricing, and the views expressed through the Storage consultation process, it is important for Ofgas to understand the views of shippers on this proposal, and the basis for those views.