



23 December 1997

Mr Nigel Shaw
Director
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Dear Nigel

Potential changes to the energy balancing regime for winter 1997/98

Introduction

On Tuesday 16 December, Transco forecast that the system was likely to be short of gas. As a result, Transco bought gas at 16.96 p/kWh, or a little under £5/therm. As a result of these actions, SMP on the buy side was set at 16.96 p/kWh (£4.97/therm) while SAP was set at 1.21p/kWh (35.5p/therm). Similar prices on the SMP buy side ensued on Wednesday 17 December although SAP was set at 4.34p/kWh (127p/therm). When compared to the prices generated in the rest of the week, these prices look excessive (SMP on the buy side being set up to 0.85p/kWh (25 p/therm) and SAP being set up to 0.57p/kWh (17p/therm)).

Ofgas has concerns that the high SMPs (and a high SAP on Wednesday) were not a proper reflection of the competitive supply and demand conditions. That is, while Transco was buying gas at high prices, there remained the potential for extra gas to be delivered to the system. There have been several suggestions as to why this gas was not available. They include:

- the triggering of the "V factor" that prevents interruptible gas storage bookings being delivered once demand is predicted to be above a particular level;
- shortage of gas at the beach due to offshore problems on the day;
- the way in which Transco was operating the flexibility mechanism;
- the bidding policy of several companies, and
- a reduction in the number of customers who were willing to interrupt.

Investigation of these issues will take some time. However, it is also being suggested that shorter term changes are needed for the rest of this winter.

Suggested changes to the energy balancing regime

On 18 December 1997, Transco held a meeting to discuss what action, if any, should be taken this winter. Discussion then, and subsequently, came up with the following list of options:

Removal of the V factor

This has been suggested by NGC UK Ltd (as modification 201). It suggests that removal of the V factor would enable interruptible storage to be delivered on high demand days.

Reopening of the storage booking service

Storage bookings for this winter were closed on 30 November 1997. Not all of the storage space and deliverability was booked by that date. BG Storage has suggested that shippers may wish to book storage (that is, space coupled with deliverability) now in order to allow injection over the Christmas and New Year period.

Auctioning remaining storage services

NGC UK Ltd has proposed (as modification 205) that BG Storage be required to make available, by way of auctions, a) storage space and b) storage deliverability. It proposes that all remaining space and deliverability is auctioned, separately, at market clearing prices.

Using Rough interruptible deliverability at peak times

Transco has suggested modification 205a as an alternative to the NGC modification 205. This suggests that on high demand days, interruptible storage gas could be delivered, subject to a surcharge.

At the meeting on 18 December, three other suggestions were made:

Reducing the value of "N"

This is a multiplier, currently set at 50, which defines the price that top-up gas is made available onto the flexibility mechanism. It was suggested that the value of N could be reduced, so acting as a cap on prices in the flexibility mechanism.

Placing top-up gas on the flexibility mechanism

It was also suggested that Transco be allowed to place top-up gas or operating margins gas onto the flexibility mechanism at lower prices than it currently places such gas on the mechanism if this could avoid high prices being set. Transco was concerned that the security of the system could be affected if this gas was used in this way.

Changing the operational guidelines

It was suggested that the operational guidelines be altered, perhaps so that the changes made from October 1997 were reversed. It has also been suggested that Transco's actions in the flexibility mechanism, despite more information being made available by Transco from January 1998, remain unpredictable.

No action

It was suggested that no action at all should be taken until after the winter was over.

Potential short-term changes

Ofgas remains concerned at the potential for excessive prices during the rest of the winter. If any action was to be taken, Ofgas considers that it be in relation to storage gas deliverability. There are two areas where we are considering taking action. First, we received a request from BG Storage that it be allowed to open, and keep open, its firm storage booking period open for as long as shippers are prepared to book its services. While we are not sure that any shippers would want to take this opportunity when modification 205 is out for consultation, BG Storage advised us that some shippers would in fact wish to book storage prior to modification 205 being determined. In these circumstances, we see no reason why shippers should not be able to book firm storage services if they so wish. We have therefore directed Transco to change its network code to allow this.

Second, NGC UK Ltd has suggested (as modification 205) that all remaining storage space and deliverability be auctioned off at market clearing prices. If a further change was considered necessary for this winter, Ofgas would favour this particular modification. While we realise that such a change could alter the commercial positions of companies that made storage bookings before this winter, it appears to us to be the least distorting method for increasing gas deliverability at times of peak demand.

As for the other suggested changes, we do not anticipate supporting them at this stage for implementation this winter.

Longer term changes

There are several other initiatives underway. First, in January 1998, we will be issuing a review of the need for top-up gas. This will be in time for consideration of our findings before the start of storage bookings for 1998/99.

Second, we will be undertaking a further review of energy balancing. It is likely that this will take the same form as this year's review, that is, a period of analysis starting in March 1998, followed by discussion of options, leading to proposals for winter 1998/99. As with this year's review, we will include a full analysis of Transco's actions in the flexibility mechanism. We are intending more radical changes than were possible for the winter of 1997/98 to be discussed and implemented. To that end, in February / March 1998, we will be issuing a more detailed consideration of the way in which the energy balancing regime should be developed, prior to beginning our analysis of the events of this winter.

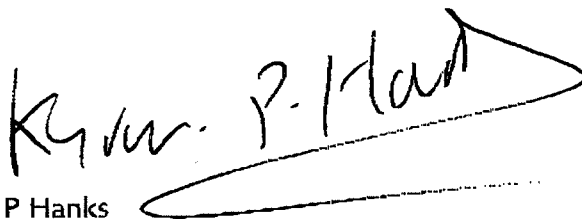
Third, as indicated in our earlier letters on the balancing regime, we will be investigating the flexibility bids of any company that had excessively-priced bids accepted by Transco. To that end, we will be writing to the several companies that had bids accepted by Transco at or near 17p/kWh (£5/therm) to seek their explanation as to how these bids are consistent with condition 2 of the shippers' licence which requires that shippers should not take actions that prejudice the efficient balancing by (in this case Transco) of its system. For example, we will be asking for evidence that these bids can be justified as cost-reflective. We anticipate publishing the findings of these investigations in the New Year.

Fourth, we expect the V factor to be removed before the start of bookings for the next storage year. This will require a modification to that effect to be brought forward prior to the booking for the storage year 1998/99.

Finally, after the Winter, we will be undertaking a review of the pricing and availability of interruptibility. This should enable us to ascertain whether availability of gas has been affected by the wishes of customers to move from interruptible to firm gas supplies.

I have also sent his letter to John Lockett who has agreed to circulate it to shippers and customers.

Happy Christmas.

A handwritten signature in black ink, reading "Kyran P. Hanks", is written over a horizontal line. The signature is stylized, with the first letters of the first and last names being capitalized and prominent.

Kyran P Hanks
Director, Transportation Regulation