

98/01/08/11



08 January 1998

Direct Dial: 0171-932-1655
Our Ref : NRF/CMS/MOD/11

Mr Nigel Shaw
Director
Transco
31 Homer Road
Solihull
West Midlands B91 3LT

Dear Nigel

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

On 23 December 1997, we wrote to you expressing Ofgas' concern that the high System Marginal Prices during 16 and 17 December did not properly reflect competitive supply and demand conditions and thereby could have had an adverse effect on customers and/or suppliers. Our letter described a number of suggested changes to the current energy balancing regime. In particular, it described two areas for change in the short term.

In terms of short term changes, we explained that we had, at the request of Transco, directed Transco to change its network code to allow BG Storage to open, and keep open, its firm storage booking period for as long as shippers are prepared to book its services. We also said that if a further change was considered necessary for this winter, we would favour adopting a suggestion from NGC UK Ltd (modification 205) that all remaining storage space and deliverability be auctioned off at market clearing prices.

In this letter we wish to outline our position on modification 205 in the light of the views expressed by respondents. In addition, we wish to respond to BG Storage's subsequent proposal to sell the remaining firm deliverability at present prices (modification 205a).

Modification 205*Summary of responses*

In general, responses were opposed to the adoption of this proposal at this stage, and Transco's report reflected this. In particular, those opposed were concerned about the effect of changing the rules in the middle of a charging year. It was argued that this would seriously affect the value of past investments (including storage deliverability and other purchases to meet peak such as swing in gas supply contracts). Moreover, it was argued that it would add to the riskiness of similar investments in future years.

Those who supported the modification expressed concern that BG Storage had been able to charge above market rates. They were also concerned that restrictions on access to deliverability rights were artificial, and that this could allow the use of market power to set prices above costs. Although only 4 respondents supported this specific proposal (together with a shipper who contacted Ofgas to express support for the proposal after close-out), several suggested that action should be taken to remove artificial constraints.

Ofgas' Views

Ofgas supports the principle underlying modification 205, that is, the separate auctioning of storage space and deliverability by BG Storage, (along with the removal of other artificial aspects of the market arrangements - such as the V factor), and would wish to see it adopted at the earliest possible opportunity.

Given the potential adverse effect on customers as a result of inaction now, Ofgas is surprised by the amount of opposition to the proposal, particularly given that some of those who opposed the proposal were also those shippers who had previously expressed strong concerns at the events of 16 and 17 December. However, we also note shippers' views that the market will adjust without intervention to reduce the likelihood of repeat circumstances in future. In particular, we understand that some shippers have recently renegotiated, or are in the process of renegotiating, the terms on which they may interrupt under their supply contracts.

On this basis, given the strength of opposition expressed in the consultation together with recent developments in the market since the proposal was made, we have decided to reject modification 205. We do so reluctantly, since we consider the protection of customers' interests must be paramount. If similar events/prices occur again as occurred on 16 and 17 December we shall investigate the position carefully. If we found evidence of anti-competitive practices or an abuse of a dominant position, we shall not hesitate to take action under our Gas Act or competition legislation powers. In any event, we are investigating the actions of those shippers that had high priced bids taken on 16 and 17 December. We intend to publish a report, including the views of those shippers (subject to any issues of commercial confidentiality) and the views of Transco, together with Ofgas' view on those matters.

As indicated above, given the views of a number of respondents on the appropriateness of auctioning storage services in future, we would expect proposals to modify Transco's network code to allow for the auctioning of storage services for the 1998/99 storage year to be fully explored.

Modification 205a*Summary of responses*

Several respondents to the consultation on modification 205 also gave their views on modification 205a. In general there was little support for the modification per se. Respondents who supported the proposal generally did so only insofar as it was an alternative to modification 205, but appeared to believe that leaving the network code unamended would be preferable.

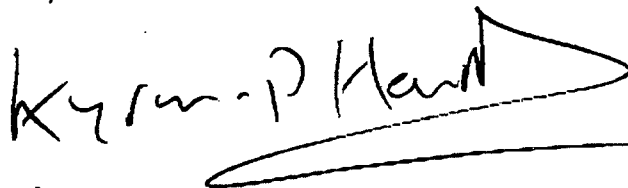
Ofgas' Views

On the basis that those respondents who supported the adoption of modification 205a believed that it would be preferable to leave Transco's network code unamended, Ofgas has rejected this modification.

The events of 16 and 17 December have proved useful in generating a discussion on the issues associated with the availability of peak deliverability, including the role of storage services in that regard. However, we do not now expect changes to be made to the energy balancing regime for the rest of this Winter.

It would be helpful if Transco could circulate this letter.

Yours sincerely

A handwritten signature in black ink, reading "Kyran P Hanks". The signature is written in a cursive style with a large, sweeping loop at the end.

Kyran P Hanks
Director, Transportation Regulation