

98/04/06/01.



1 April 1998

Dear Shippers, Transco and BG Storage (and other interested parties),

SALE OF BG STORAGE SERVICES IN 1998/99

Ofgas has been considering a number of proposals relating to the manner in which BG sells its storage services.

Sale of Rough Services

These proposals have included one which requires BG, by way of a modification to the network code, to sell capacity at Rough for the next storage year by auction; a proposal which Ofgas and the majority of shippers who responded to the consultation supported. BG has made it clear that it will not willingly accept such a proposal and, at a late stage in the modification process, argued that it is not legally possible for it to be required to do so. It is clear that it would be legally possible to implement that proposal with the cooperation of BG.

The legal issues raised by BG are complex. Ofgas has concluded that continuing the current uncertainty over the sale of BG's storage services is not in the best interests of the industry; nor would a protracted legal dispute further the development of competition in storage. Nevertheless, we remain of the view that an auction would benefit the industry as a whole, provide information of great value to the future development of the storage market, and help to ensure that BG maintains its system economically and efficiently.

BG has said that any modification of the Network Code must relate to matters properly within the Code, and that condition 7 of its public gas transporter's licence defines these matters as those which are not covered within conditions 3 and 4. BG believes that the proposal to sell Rough capacity by way of an auction falls under conditions 3 and 4, since it is a matter relating to the charges to be made in pursuance of transportation arrangements (which include storage arrangements in respect of Rough). Ofgas' powers under conditions 3 and 4 in respect of BG's charging methodology are limited to vetoing (or not vetoing) changes proposed by BG (the licence states that the Director General has 28 days from receipt of a proposal to direct that such a modification not be made). In this case, in the event of Ofgas deciding to veto BG's fixed price proposals, the industry would be faced with the current charges continuing for another year until 30 April 1999.

BG's existing charges for Rough space and deliverability are 0.135p/kWh (3.96p/therm) and 21.002p/pdkWh (615.5p/pdtherm) respectively. Under BG's current proposals the space price would be increased by 25% to 0.169p/kWh (4.95p/therm) and the deliverability price would be reduced by 50% to 10.5p/pdkWh (308p/pdtherm). Based on responses to BG Storage's consultation, BG's proposed fixed charges for 1998/99

represent an improvement on the current charges. In the circumstances, Ofgas has decided not to veto BG's proposed pricing changes.

We have agreed with BG that the tender for Rough services should be issued on 2 April and that the deadline should be 22 April. This requires several consequential modifications to the Network Code, which we expect to direct on receipt of application from Transco.¹

V Factor and On the Day Trading

As part of its proposals for the sale of storage services in 1998/99, BG proposed several changes to its Rough storage services (described in Network Code modification 220). The main change proposed was the removal of the V Factor. This would have the effect of removing the constraint on the withdrawal of gas stored under BG's 'space only' service at times when demand exceeded 85% of peak demand.

BG also proposed to sell deliverability capacity which was unused on the day. BG has further agreed to develop a mechanism for auctioning unused capacity on the day for implementation later this year.

Ofgas supports these proposals and therefore accepts this modification.

Top-up gas and related storage services

At present, Transco is required to place Top-up gas in storage to enhance security of supply. By its physical presence, Top-up is intended to ensure that firm demand can be met under severe weather conditions as laid out by security standards in the licensing framework. In addition, the mechanism by which Top-up gas is priced and bid into the flexibility mechanism is designed to give shippers an incentive to make sufficient provisions to meet their own peak demand. On 2 February 1998 Ofgas published a consultation document reviewing the future need for Top-up gas (and associated storage bookings).

Our initial view, which has since been supported by the majority of respondents, was that the requirement for Top-up gas could be removed from 1998/99. In response to the consultation, the Health and Safety Executive (HSE) pointed out that Transco has said before the requirement to book Top-up gas could be removed it would wish to resubmit its safety case to the HSE. The HSE says it would not be possible to remove the requirement on Transco to book Top-up gas by the beginning of the 1998/99 storage year; however, in Ofgas' view, this would not necessarily mean that shippers should continue to bear the costs of Top-up gas.

If all storage services, including Rough, were auctioned, this would be likely to negate the need for Top-up. Given that BG has resisted auctioning its services, Ofgas needs to consider whether it would be appropriate for shippers to pay Transco's Top-up gas costs.

¹ The Network Code currently requires BG Storage to invite applications for storage capacity in each of its facilities not later than 1 March in the preceding storage year. It also requires that the deadline date shall be at least 30 days after the date of the invitation and that BG Storage inform each User of its registered storage capacity not later than 7 April in the preceding storage year. In response to a written request from Transco, we intend to direct the necessary modifications to the Network Code for the 1998/99 storage year only.

Ofgas will be giving these issues further consideration over the next few days. We expect to issue a fuller statement of our conclusions on the future need for Top-up gas by Easter.

Hornsea and LNG storage services

BG Storage has already issued a tender for Hornsea and LNG services in 1998/99. A deadline for responses was set for 6 April. We believe it would be helpful for its customers if the deadline for Hornsea and LNG services was extended to bring it into line with the timetable for the tender of Rough services, ie a deadline of 22 April 1998. BG has agreed to this.

Ofgas Investigation

Transco's approach to the sale of its storage services has reinforced Ofgas' concerns about the underlying structure of the market and pricing of storage and related services. Ofgas therefore has now launched a detailed inquiry into the structure of the market and the behaviour of the dominant participants in it. In conducting this inquiry, Ofgas will have in mind its powers under both the regulatory regime for gas and general competition law. The Director General may, to the extent that it is appropriate, conduct the inquiry using her powers under the Fair Trading Act 1973 and the Competition Act 1980. On conclusion of the inquiry the Director General will consider whether one or more references to the MMC is appropriate. Ofgas will continue to monitor closely BG's compliance with the provisions of its licence, including those which relate to its storage business.

Yours sincerely

Clare Spottiswoode

**CLARE SPOTTISWOODE
DIRECTOR GENERAL OF GAS SUPPLY**

Timetable for Sale of BG's Storage Services

Thursday 2 April	BG circulates Invitation to Tender for Rough services
Wednesday 8 April	BG holds open meeting to explain tender (Venue to be arranged)
Thursday 9 April	Ofgas issues statement on Top-up
Wednesday 22 April	Rough tender closes after 3 weeks; tenders for Hornsea and LNG services also close
Monday 27 April	BG confirms allocation of capacity
Wednesday 29 April at 12 noon	Deadline for requesting May injection capacity
Thursday 30 April at 12 noon	BG confirms May injection programmes