

98/04/02/04



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Your Ref :

Dr John Lockett
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Dear Dr Lockett

NETWORK CODE MODIFICATIONS 218, 220 AND 222

Following the Director General's letter dated 1 April, Ofgas have approved the implementation of Modification 220, Rough Services 1998/99(core). Given our approval of Modification 220, we subsequently reject Modifications 218 and 222.

It would be helpful if Transco could circulate this letter and our letter dated 1 April.

Yours sincerely

A handwritten signature in cursive script that reads "Saunders".

Matthew Saunders
Transportation Regulation

98/05/01/03

**Urgent Modification Proposals 218, 220, 222****Rough Storage Services 1998/99*****Introduction***

In recent weeks Ofgas has received a number of formal proposals for modifying the Network Code for Rough storage services. On 6 March 1998 Ofgas agreed that four modifications should be considered by the industry on an urgent basis:-

- modification 218 (proposed by NGC UK);
- modification 220 (proposed by BG);
- modification 221 (proposed by BG); and
- modification 222 (proposed by Enron).

Modification 221 - a proposal to continue the current fixed price approach to the pricing of Rough services through 1998/99 - was subsequently withdrawn on the grounds that it did not involve any modifications to the Network Code.

After describing the position in 1997/98, modifications 218, 220 and 222 are described below. Ofgas' decision on each of these modifications is summarised, together with a short description of the impact on customers. More details can be found in Ofgas' decision letter, dated 1 April 1998 from the Director General of Gas Supply.

1997/98 Position

The Network Code states that BG's storage business can choose to offer capacity for each of its facilities at fixed prices or by way of an auction. In the 1997/98 storage year, BG offered capacity at Rough (for its firm and interruptible services) and its LNG facilities at fixed prices, and offered Hornsea capacity via an auction. BG's 1997/98 charges for Rough space and deliverability were 0.135p/kWh (3.96p/therm) and 21.002p/pdkWh (615.5p/pdtherm) respectively.

Modification 218 - An Auction of Rough Services 1998/99 (proposed by NGC UK)

This proposal required BG's storage business to auction two Rough services:-

- a firm, 30 day withdrawal, 50 day injection service; and
- an interruptible service (with 50 day withdrawal rights).

The auction would include a reserve price to guarantee recovery of around £30m from Rough. In addition, any under recovery against BG's storage business' revenue cap would be recovered via balancing neutrality charges at the end of the 1998/99 storage year.

1998/99 Prices

The withdrawn modification proposal 221 was resubmitted to Ofgas as a change in BG Storage's charging methodology under conditions 3 and 4 of BG plc's licence. Ofgas' powers in respect of these licence proposals are limited to the vetoing of proposed changes. Under this proposal, the Rough space price would be increased by 25% to 0.169p/kWh (4.95p/therm) and the Rough 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. These new charges will take effect on 1 May 1998.

Impact on Customers

There is no direct impact on customers. As noted above, the immediate removal of an artificial constraint to withdrawing gas stored at Rough on days of peak demand (the V-factor rule), along with the 50% reduction in the price of Rough firm services, should have a beneficial influence on the price of peak gas, which should, in a competitive market, ultimately reach customers. Customers should keep an eye on developments following Ofgas' review of storage and related services.

Further Information

The BG contact is Martin Kinoulty on 0121 711 6238.
The Ofgas contact is Andy MacFaul on 0171 932 1683.

Modification 220 - Rough Services 1998/99 (Core) (proposed by BG)

The main features of this modification were as follows.

First, it proposed to remove the constraint on the withdrawal of gas stored under BG's interruptible (or 'space only') service at times when demand exceeded 85% of peak demand (called the 'V-Factor').

Second, the proposal gave BG the option to sell deliverability capacity which was unused on the day. However, BG would need to develop a basis for selling this capacity. Potentially, this could be implemented in time for winter 1998/99.

Third, the proposal would also remove the distinction between space capacity under the firm and space only services, so that all space would be treated in the same way.

Modification Proposal 222 - Rough Storage Tender (proposed by Enron)

Enron proposed that Rough services should be auctioned without a reserve price.

Rough would be auctioned in two stages. First, a firm 30 day service with deliverability sold to successful bidders at the market clearing price. Stage two would involve selling any remaining space as a space only service at market clearing prices.

Under the proposal, BG's storage business would offer, on a first come first served basis, special storage injectability and deliverability capacity. This capacity would be interrupted if holders of firm storage capacity required it. However, special deliverability would hold priority over interruptible deliverability capacity.

The modification also proposed that an award of more than 70% of available space and deliverability to any one shipper (including affiliates) should be subject to Ofgas approval to avoid potential abuse of a dominant position.

Ofgas Decision***Modification proposals***

Ofgas supported, along with a majority of shippers, the principle of auctioning Rough storage services. We believe that an auction would provide information of value to the future development of the storage market, and help to ensure that BG maintains its system in an economic and efficient manner.

However, BG raised a number of complex legal issues which were unlikely to be resolved in advance of the 1998/9 storage year. Ofgas therefore decided to accept modification proposal 220 defining the storage services to be offered from Rough, and to reject the modification proposals 218 and 222 on auctioning Rough storage services.

We have now also initiated a detailed investigation into the market for storage and related services, and the behaviour of the dominant participants in it. The main purpose of this review is to collect and assess evidence of the existence and use of market power in the provision of storage and related services.