

98/10/07/09



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Transco, Shippers and other interested parties

Dear Colleague

Modification Proposals 0271 and 0272

Ofgas has written several letters expressing concern about the nomination behaviour by shippers in the light of the physical availability of capacity at St. Fergus. In our latest letter of 2 October we said that we stand ready to implement modifications 0271 and 0272 at any time should the situation warrant it. Since then the situation has worsened with daily constraint costs in excess of £800,000 on two occasions. The total estimated cost of constraint actions at St. Fergus is now nearly £18 million.

Ofgas considers that inaction in the face of the present situation is unacceptable. It is damaging competition in shipping and supply and failing to provide adequate protection to consumers. Transco has recommended that, of the modifications proposed, Ofgas agree to implement modification 0271 subject to a number of minor and one substantive amendment. After very careful consideration Ofgas has decided to accept that modification 0271 be introduced so as to take effect for the Gas Flow Day commencing at 6.00 am on Friday 9 October 1998, for a period of 28 days. In reaching this decision Ofgas has had regard, among other things, to:

- i) the financial implications for shippers of the continuation of balancing charges at their recent levels;
- ii) the effect of the continuation of current balancing measures on gas prices generally;
- iii) distortions in the competitive gas market arising from the continuation of current balancing charges;
- iv) the recent escalation in the level of balancing charges being incurred;
- v) safety issues;
- vi) the fact that neither modification 0271 nor modification 0272 was widely supported by shippers; and
- vii) the interests of consumers.

Overall Ofgas is of the view that the introduction of modification 0271 will better facilitate the achievement of the relevant objectives of Transco's Network Code as compared with leaving the Code unmodified.

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The substantive amendment to modification 0271 is the introduction of an obligation on shippers to not nominate in excess of available restricted capacity at St. Fergus. Ofgas will have close regard to the level of nominations and whether they are kept in line with capacity, when reviewing the performance by shippers in relation to condition 2(2) of the standard conditions of shippers' licences. This condition requires shippers not to prejudice the efficient balancing by Transco of its system.

We recognise shippers' concerns that capacity trading must occur at St. Fergus in order to ensure the smooth operation of modification 0271. We have put in place a formal undertaking with British Gas Trading to ensure that capacity is made available at a reasonable price. The basis of the undertaking is attached to this letter. The precise arrangements for selling capacity will be kept under review.

Ofgas also will be closely reviewing the following points.

- ◆ Whether modification 0271 operates effectively to reduce constraint costs and if additional modifications are necessary.
- ◆ Whether some rebate should be paid to cover the difference between shippers' booked and pro-rated capacity since their capacity entitlements will be reduced as compared to the booked capacity that they have paid for.
- ◆ How to ensure that Transco has an incentive to reduce costs of constraints because it is revenue neutral. One shipper has raised a modification proposal covering this issue which we intend to treat as urgent. We would expect to support a modification which places responsibility on Transco to pick up a proportion of constraint costs commensurate with their ability to make capacity available, for example when actual physical capacity is lower than the maximum physical capacity due to the carrying out of reinforcement or maintenance work. We would expect the effect of such a modification proposal to operate from 9 October, the implementation date of 0271.
- ◆ More substantive arrangements to help improve the liquidity of the capacity market. One possibility would be to pro-rate booked capacity to below the total physically available capacity, with Transco auctioning the resulting spare capacity. Alternatively Transco could auction all the capacity at St. Fergus with no player being able to buy more than say 20%. We will be discussing these possibilities with Transco and other interested parties.

Yours sincerely

Clare Spottiswoode

CLARE SPOTTISWOODE
DIRECTOR GENERAL

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