



02 October 1998

Direct Dial: 0171-932-1661
Direct Fax: 0171 932 1662
Our Ref : stf_0110

Transco, Shippers and other interested parties,

Dear Colleague,

Modification Proposals 0271 and 0272

Ofgas has received the final modification reports for proposals 0271 and 0272 from Transco. We have read through the representations from shippers and other interested parties and are conscious that support for these proposals is very limited. Transco has recommended the implementation of modification proposal 0271 if there is no reduction in activity at St. Fergus.

Ofgas is concerned that nominations at St. Fergus continue to exceed the available capacity. Transco has indicated that the scale of the problem now exceeds £14 million. This figure causes us a great deal of concern. We have asked Transco to provide us with data to show the effect of the smeared costs on individual shippers. Although this data is estimated on August throughput (and thus subject to change) it does indicate that there are some substantial "winners" and "losers" from the smeared costs arising from constrained system sells (and corresponding system buys) at St. Fergus. There is, however, no obvious link between comments made by "winners" or "losers" and support for the proposals.

It is our belief that there are numerous direct and indirect costs which arise in these circumstances. Shippers may suffer cash flow problems as they are presented with higher than expected neutrality charges; those shippers that do not ship through St. Fergus face exposure to costs that are particularly unjust. Smaller shippers may be particularly vulnerable. Customers are inevitable losers since they will ultimately bear the costs of any constraints action.

Ofgas has begun its investigation into the possibility that shippers may have "gamed" at St. Fergus. This investigation may take some time to complete. If we find evidence of gaming we would expect to establish a licence breach. Our power to take action against an offending shipper will depend on our assessment of the likelihood of continued gaming but could include a monetary penalty, possibly related to the smearing costs incurred. We also note that the network code can, and has been, amended retrospectively in exceptional circumstances.

Many shippers have commented that Transco does not have any incentive to reduce the costs of constraints because it is revenue neutral. One shipper has contacted us because it is their intention to raise a modification proposal which will impose some liability on Transco where a terminal is constrained. We expect that discussions will result in the tabling of a modification proposal. In our letter of 22 September, Ofgas recognised the views expressed by many shippers that some costs resulting from constraints at St. Fergus should be apportioned to Transco. We continue to believe that this merits further urgent discussion.

05/10 '98 MON 09:43 FAX 01719321675

NETWORK OPPS

003

It is still of concern that reinforcement at St. Fergus has exceeded the original timetable. Whilst we accept that delays may be the result of poor weather in June, we believe that Ofgas needs to consider whether delayed investment by Transco and its planning of this reinforcement programme has contributed to the very high costs to the industry and to customers. We note that the actions of shippers and Transco can cause constraints to arise but that present network code provisions mean that only shippers bear these costs.

Shippers have complained that capacity trading at St. Fergus is very illiquid and that a significant shipper at St. Fergus has stated that it will not trade capacity. We are investigating these allegations urgently and will take early action if necessary.

Ofgas believes that the problems that have been exhibited at St. Fergus would be significantly reduced or even eliminated with the introduction of an On-the-day Commodity Market (OCM), together with properly defined entry capacity rights and appropriate incentives on Transco. Work groups are scheduled to progress this issue next week. We consider that modification 0271, if implemented, would be a move in the right direction.

We are monitoring events at St. Fergus closely and believe that it is right to delay our decision on modifications 0271 and 0272. We are conscious that customers are losing out directly, as they bear smeared costs ultimately, and indirectly through the diversion of gas away from the spot market and onto the flexibility market, which contributes to increasing spot prices. For all these reasons we stand ready to implement these modifications at any time should the situation warrant it.

Yours sincerely

Clare Spottiswoode

CLARE SPOTTISWOODE
DIRECTOR GENERAL