

98/11/12/03



09 November 1998

Direct Dial: 0171-932-1689

Our Ref. : SD/Mod 273

Your Ref. :

Anne-Marie Pearman
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Dear Anne-Marie

Urgent modification proposal 273 "Additional entry capacity services"

Please find attached the appropriate page accepting this modification to Transco's network code.

Ofgas welcomes this modification and believes that the new services provide a means for shippers to utilise Transco's pipeline system more efficiently in the current framework. The daily service makes available unbooked but physically available capacity and the secondary service, by releasing booked but unused physically available capacity, should also stimulate more efficient use of Transco's system, either directly or by stimulating additional secondary trading of entry capacity. However, Transco and shippers should note that this is a temporary service and the BC99 project may result in a more fundamental change to the entry capacity regime and may require further end dating of existing capacity bookings.

Respondents largely supported this modification proposal but they raised a number of issues that I wish to respond to. First, the application of these services to storage entry points was raised. The service will not be available at LNG storage entry points, at least initially. I accept Transco's argument that the occasional use of these facilities makes it more difficult for Transco to model physically available capacity day ahead. I note that the pricing of these new Transco services, as defined currently, also makes it difficult to provide them at constrained LNG sites (which have negative entry charges). However, Ofgas expects Transco to monitor closely the use of, and the storage services available at, LNG storage sites with a view to possibly introducing these new Transco services at a later date. In particular, new use-it-or-lose-it storage capacity services may require matching services on the Transco system.

Second, respondents argued strongly against the end-dating of entry capacity serving storage sites half way through the storage year. In response, Transco will not end date entry capacity bookings at Hornsea, where the new capacity services will be available, nor at LNG sites, where the new capacity services will not be available. However, because of the bundled nature of entry capacity at Rough and Easington, entry capacity serving the Rough storage facility will be end dated. I accept that this may cause concern to shippers holding that capacity. Ofgas looks to shippers and Transco to work together to identify, before the end of this current storage year, a means by which entry capacity booked to service Rough can be identified separately and end dated at the end of the storage year.

Third, a number of shippers expressed the concern that Transco has no incentive to monitor accurately and make available day ahead all the capacity physically available. In particular, while it retains the revenue from these services, Transco may have an incentive to restrict capacity availability to generate high prices in the subsequent auction. To the extent that these services lead to more gas being transported by Transco, Transco will have an incentive from the price control to ensure that these services are made available at maximum levels. However, Ofgas also expects Transco to keep these services under review and to report to Ofgas and the shipping community on its performance in forecasting day ahead capacity availability and on take up of these services by the community.

Transco should also monitor and report on a number of other issues. Transco should monitor closely the nomination behaviour of incumbent holders of annual entry capacity to ensure that such parties do not cause holders of secondary capacity to be scaled back unnecessarily. This issue should be addressed in Transco's report to Ofgas. However, should Transco identify such behaviour, it should report to Ofgas immediately. Ofgas also expects Transco to monitor closely whether parties with upstream information are better able to utilise these services. In particular, Ofgas would be concerned if shippers were able to use upstream information inappropriately, given the blind bidding envisaged by Transco currently, that is Transco will not inform shippers in advance of the capacity available under each service. In line with Special Condition 9C of its PGT licence, Transco should also report to Ofgas promptly should these new capacity booking levels and take up of these new services begin to impact adversely on Transco's recovery of its allowed revenue.

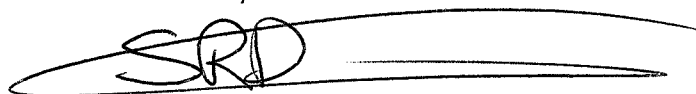
Ofgas expects Transco to produce a report, covering all the above issues, three months after implementation of this modification.

Finally, a number of respondents commented on the applicability of this modification proposal to St Fergus terminal during the current constrained situation, taking into account the operation of modification 271 (as extended by modification 288). Ofgas notes that in the current constrained situation, where shippers have booked capacity and are attempting to deliver gas in excess of the entry capacity physically available, neither of the services proposed under this modification would make additional capacity available. However, we believe it is important for this modification to be implemented at all entry points (except LNG storage sites at present) including St Fergus. In particular, it will, by end dating capacity now, remove the incentive on shippers to increase significantly their capacity bookings with the expectation of being end dated in the near future. Ofgas is already monitoring closely capacity booking behaviour at St Fergus since the introduction of modification 271 and will be extra vigilant between approval of this modification and implementation of the end dating routine.

Ofgas will respond separately to Transco with regard to its proposed transportation charging methodology change (PC36).

Please circulate this letter widely.

Yours sincerely

A handwritten signature in black ink, appearing to read 'SRD', is written over a horizontal line.

Shaun Day
Economic Adviser
Head of Transportation Pricing