Modification Report
URGENT Modification Reference Number 275

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.12.4.

1. Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.2(a) Ofgas has agreed that this Modification Proposal should be treated as Urgent as it relates to the St Fergus constraint issue.

2. Procedures Followed:

Transco agreed with Ofgas the following procedures for this Proposal;

a. Close out of representations would be 26 October 1998

b. Final report to Ofgas 30 October 1998

As reported at the Energy workstream on 10 November 1998 the Modification Report has been delayed and will be sent to Ofgas by 13 November.

3. The Modification Proposal:

This Modification proposal changes the methodology by which an individual shippers' balancing neutrality charge is calculated on days of terminal constraint, so that recovery of the charge is targeted predominately at the constrained terminal. Furthemore the modification proposes that Transco undertakes to pay a percentage of the costs incurred during times of terminal constraints.

The Modification proposes that on days when Transco signals a terminal constraint and sells gas via the flexibility market, the balancing neutrality charge arising on that day will be recovered from 50% beach inputs specific to the location of that constraint, 25% from all beach inputs and 25% from all outputs. Transco will pay a liability payment, equal to 10% of the balancing neutrality charge arising on that day, to the community in direct proportion to the amounts invoiced to each shipper on the day. This will ensure that constrained balancing neutrality charges will be recovered 10% from Transco and 90% from the community.

This liability would not be included in the current Transco liability cap.

4. Transco's opinion:

This Modification Proposal seeks to retarget neutrality costs towards the constrained terminal for shippers and Transco. It does not however provide any evidence or analysis to support either the targetting of constrained terminals or the proposed means of apportionment. Furthermore there is no objective consideration of any potential impacts on shippers or Transco either financially or in potential behavioural terms.

Whilst the proposal acknowledges that factors elsewhere on the system can influence or cause constraints it then ignores this issue by placing the main burden of costs at the constraint. It makes no attempt to differentiate or identify those shippers whose actions may be causing or exacerbating a constraint situation.

With regard to Transco attracting a liability through neutrality, the same issues outlined previously apply. In addition, by remaining neutral with regard to energy balancing, Transco neither gains financial benefit or faces liability for balancing actions. It would be inequitable for Transco to face liablities without the potential to equally gain financially. This issue was recognised by the industry as being extremely complex, especially given the major changes this would have on Transcos commercial behaviour. On that basis it was incorporated under BC99 and it would be inappropriate to prejudice or pre-judge the outcome of that review.

In addition, as mentioned previously, Transco has no control over shippers commercial balancing decisions. It is therefore not clearly inappropriate to target costs related to something which Transco cannot control. The effect of this will be to subsidise shippers balancing costs and therefore encourage further actions which generate constraints, something the industry has been attempting to prevent over the past few months.

Transco's exposure to liability payments is currently being addressed through modifcation 287/287a, Transco entry capacity liability at St Fergus. Additional exposure through neutrality is therefore not appropriate.

This modification does nothing to address the underlying causes of constraints and runs the risk of increasing them.

5. <u>Extent to which the proposed modification would better facilitate the relevant objectives:</u>

This modification will not better facilitate the relevant objectives as it will not encourage the efficient and economic operation of the pipeline system, for the reasons outlined above.

By targetting costs in an arbitrary manner at those shippers flowing gas at a constrained terminal, it is likely to reduce effective competition by placing undue financial burdens on those who may not be responsible for the constraint.

6. The implications for Transco of implementing the Modification Proposal, including:

a) implications for the operation of the System and any BG Storage Facility:

This proposal is likely to encourage further constraint actions by subsidising the cost of constraints and encouraging those shippers who are able, to raise nominations and take flex sells to minimise risk and maximise returns.

b) development and capital cost and operating cost implications:

Operating costs are likely to rise in order to compensate for distorted input nominations associated with the constraint

c) extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:

Not Applicable

d) analysis of the consequences (if any) this proposal would have on price regulation:

The prospect of Transco facing liabilities through neutrality was not envisaged under the current formula. The impact of this would have to be considered further.

7. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal:

Transco would face uncontrolled exposure to shippers balancing actions with regard to constraints.

8. The development implications and other implications for computer systems of Transco and related computer systems of Relevant Shippers:

Not applicable

9. The implications of implementing the Modification Proposal for Relevant Shippers:

Shippers with supply contracts at constrained terminals will face additional costs not evisaged at the time of taking out those contracts. These costs may be incurred despite the constraint being caused partially or wholly by other factors elsewhere on the system. Shippers with less flexible contracts will face financial risks, which are likely to be difficult to control or mitigate.

10. **<u>The implications of implementing the Modification Proposal for terminal operators, suppliers, producers and, any Non-Network Code Party:</u>**

The changes proposed in the Modification will increase uncertainty and therefore place more burden on non network parties.

11. **<u>Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each Relevant Shipper and Non-Network Code Party of implementing the Modification Proposal:</u>**

Liability payments by Transco through neutrality will change commercial behaviour, leading to a more adversarial situation between Transco and shippers. Information crucial to the efficient operation of the system is likely to be witheld for commercial advantage by all parties. Unless carefully analysed, understood and regulated this could lead to major changes in the current regime.

12. **<u>Analysis of any advantages or disadvantages of the implementation of the Modification Proposal:</u>**

Advantages

None

Disadvantages

Targets costs in an arbritary manner
Does not address the causes of constraints
May encourage increased constraint activity

13. **<u>Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report):</u>**

Of the 19 respondents, 12 (63%) shippers were opposed to the proposal, 5 (26%) were in support (including the proposing shipper). A further 2 shippers did not express a clear opinion, although they did oppose the principle of shippers at constrained terminals picking up additional costs. A number of shippers (6) suggested that further analysis was required with BC99 being suggested as the most appropriate place for this to be done. 12 respondents were against shippers picking up costs and an equal number in support of Transco paying some liabilities although, as referred to above, only after sufficient analysis had been completed.

Quantum suggest that Transco should be held liable for all constraint costs. Shell Gas Direct believe Transco should be properly incentivised and did not think the arbitrary nature of the proposal achieves this. Nor did they support the targetting of shippers on a similar arbitrary basis. Moreover they were concerned that shippers with flat supply contracts would be able to do little to reduce flows and hence smearing. Powergen were concerned about the effect on "innocent" shippers. BP felt that the proposal did little to target those who create the costs by exacerbating the constraint and certainly does not increase effciency. Marathon believed that it is an industry problem and suggested investigation by Ofgas of behaviour at constrained terminals. British Gas Trading supported the principle that Transco should pick up some costs but opposed targetting shippers as they are already suffering through being constrained. They suggested the matter be considered further as part of BC99. Yorkshire acknowledged that constraints have been due mainly to virtual gas, but costs on Transco should act as an incentive. Alliance preferred targetting shippers who benefit from constraints. Whilst agreeing that Transco should bear costs, National Power questioned the practical application of the reapportionment and suggested Ofgas identify shippers who cause constraints.They also suggested that BC99 was the forum for discussing cost targetting. Mobil suggested that Modification 271 should remain in place and that shippers who have booked capacity should not face additional balancing costs. Eastern believed it would target shippers who are acting within their Licence conditions. Scottish Hydro believed the proposal was arbitrary and Conoco that there was no realistic prospect of assigning a constraint to a particular location. Agas suggested that better cost targetting was the way forward, and Elf more detailed analysis of the St Fergus issue, whilst Transco should carry 50 - 100% of neutrality costs. They also suggested a review of entry capacity bookings.

Transco Response:

14. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation:

Not applicable

15. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:

Not Applicable

16. Programme of works required as a consequence of implementing the Modification Proposal:

None

17. Proposed implementation timetable (inc timetable for any necessary information systems changes):

Not applicable

18. Recommendation concerning implementation of the Modification Proposal:

Transco do not support the implementation of this modification for the reasons provided.

19. Restrictive Trade Practices Act:

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

20. Transco's Proposal:

This Modification Report contains Transco's proposal **not** to modify the Network Code and Transco now seeks **agreement** from the Director General in accordance with this report.

21. Text provided pursuant to Rule 9:

Not applicable

Signed for and on behalf of Transco.

Signature: TL

Tim Davis
Manager, Network Code

Date: 13/11/98