Network Code Modification Proposal 0429
Report to November 2000 Modification Panel
Version 1.0

1. The Original Proposal

The original proposal was as follows: -

This Modification Proposal contains elements to address inconsistencies introduced into Section P by the implementation of a number of recent Modification Proposals. The nature of each change is described below. The aim is to modify Section P in a manner which is supportive of the introduction of competition in storage, and to recognise changed relationships between Transco, Storage Operators and the Top Up Manager.

This Modification Proposal consists of changes in Section P, to aid the operation of the Top-up regime. These include:

* Correcting minor cross referencing errors
Several minor cross-referencing errors appear in Section P, which should be amended to maintain the accuracy of the Network Code. This would remove any ambiguity and misunderstanding which could otherwise materialise. These cross-references would not materially alter Section P of the Network Code as written and would be identified in the legal drafting to support this Modification Proposal.

* Re-introduce a generic definition of Facility Type
Under a previous Modification Proposal the definition of Storage Facility Type was deleted. Much of Section P relies on the definition of particular Storage Facility Types. The previous definition of Facility Types was based on named facilities i.e. Rough, Hornsea and LNG rather than the characteristics of those sites. This Modification Proposal proposes to reintroduce a definition of Storage Facility Type based on service duration derived from deliverability rates. Specifically it is proposed that three Storage Facility Types be defined based on service durations of less than 10 days, less than 30 days but greater than or equal to10 days and greater than or equal to 30 days. Defining facility types in this manner is more generic but comparable with the previous facility type definitions, and will allow Section P to function properly. These definitions would be necessary to facilitate changes to the monitoring of stocks and monitor levels mentioned later.

* The Top-up Manager should have access to information at the aggregate level for each Storage site.
Section P contemplates that the Top-up Manager will have information on gas Stocks in a facility at the individual Shipper level. This level of detail is in excess of that contemplated by the Storage Connection Agreement, which requires the Storage Operator to provide details on stocks at the aggregate level. The Top-up Manager is able to fulfil his role adequately with information at the aggregate level. This would ensure consistency with the level of information provision contemplated by the Storage Connection Agreement.

* Allow all stored gas to contribute to monitor levels
The introduction of Storage Competition has led to a requirement to change the definition of which storage bookings the Top Up Manager will use to determine whether or not a Top-up requirement exists both ahead of the year and within year. It is proposed that it would be most appropriate to only contemplate gas capable of being withdrawn during the winter period as gas, which could contribute to the monitor level. This should include all gas relating to all customers of a Storage Facility whether they are a User of Transco's System or not.

* Allow surplus Operating Margins gas to contribute to monitor levels
For supply security each facility type has a monitor level, which has to be maintained as well as an aggregate monitor level across all sites. Where a shortfall against the aggregate monitor level exists the Top-up Manager has to take action to arrange for gas to be injected into the store to maintain the declared security of supply standard. The Top-up Manager can purchase gas to inject or arrange a transfer from, if it exists, from the Operating Margins account at a price predetermined by the Network Code. Since OM and Top-up are funded by different parties it is desirable to allow surplus OM gas to be counted towards the monitor level without actually conducting a financial transfer between the Top-up and Operating Margins accounts unless the gas is used.

*Allow surplus stocks in shorter duration facilities to contribute to the stock levels required in longer duration facilities.
The Network Code prescribes a hierarchy for monitor level maintenance. For example, there may be sufficient gas stocks in aggregate across all sites to meet the aggregate monitor level but a deficit of stocks may coexist in specific facility types. Where this occurs the current rules require injections to be made into the specific facility in deficit to bring stock levels back up to the site-specific monitor level. Surplus LNG could easily act as a substitute for Rough or Hornsea and Hornsea could substitute for Rough, to some extent. To ensure the monitor levels are maintained in the most economic and efficient manner possible it is proposed that surplus stocks in shorter duration facilities should be specifically allowed to contribute to the stock levels required in longer duration facilities.

* Review supply security level within year
It is expected that as storage competition develops and the storage market becomes more differentiated the current single date driven event for determining security of supply standard may no longer be relevant. At this time a determination of the Top-up requirement for the year is made, but The Network Code does not contain a mechanism for reviewing the declared Supply Security level within year. For example if new gas storage facilities become available within year then it is proposed that it should be possible to review the declared supply security level. This would take into account any additional storage bookings in the new storage facilities, changes to forecasts of supply and demand and would enable the Top-up requirement for the year should be redetermined.

* Gas Transfers under the terms of Late Booking
Currently, the Network Code states that in the event that the Top Up Manager has unfilled Storage Space, and a User is registered as holding Storage Capacity with an application made after the Invitation close date, then the Top Up Manager will

surrender an amount of capacity equal to but not exceeding the amount of unfilled Storage Space it holds, to the User. Currently this applies to all Storage facilities. However, third party Storage Operators, except Transco LNG, may not have such provisions in their relevant Storage terms and as such it is proposed that these provisions should only apply to those Storage Operators whose Storage Terms contain matching provisions.

* Gas Transfers at 105% WACOG
The Network Code allows a Shipper to ask the Top-up Manager to transfer gas in store to a User at 105% of the Weighted Average Cost of Gas (WACOG) as defined in the Network Code. At the time the Network Code was written it was envisaged that this price was significantly high to discourage Users from asking for a gas transfer and was intended to incentivise Users to book and fill storage early. However, recent market prices have shown that 105% of WACOG has been less than the cost of NBP gas plus injection charges. This means that some Users could benefit from demanding a transfer of gas in store rather than purchasing gas from the market, in effect they could save money by forcing a transfer from the Top-up Manager when market conditions permit. Since Market prices may no longer allow the 105% WACOG incentive to work, it is proposed to establish a new mechanism for the pricing of transfers, to reintroduce the objective of incentivising Users to book Storage Capacity early, which would be 105% of the greater of WACOG or NBP gas plus injection charges of the appropriate facility in which the transfer would take place. This would keep the original incentive intact.

2. Workgroup Activity

The Modification Panel requested that the Planning and Security Workstream develop Modification 429 further and report back to the Panel.

A meeting of the Planning and Security Workstream was held on the 20th October 2000 to discuss the Modification Proposal in detail and to agree a set of Business Rules from which legal drafting can be developed.

As a result of this meeting two issues were raised requiring further investigation.

- Use of Native Gas in the Top Up determination process.
- The price of gas used in a transfer between the Top Up Manager and a Storage User.

2.1 Use of Native Gas in the Top Up determination process.

The existing process for determining the Top Up requirement ahead of the year looks at the level of Storage Capacity booked by Storage Users to identify the initial Top Up requirement. Whilst within year a Top Up requirement might materialise if the gas in store is less than the monitor level, both in aggregate and at each Facility.

The basis for calculating the level of Storage bookings which can contribute towards the Top Up determination is that the gas held in store by a Storage User (which includes Storage Operators and Non Users) could be made available to the System.

It has been suggested that Native Gas could be made available to the System and therefore should be used when calculating the Top Up requirement. For Native Gas to be available to the System it has to be capable of flowing from the Facility into the System. The questions raised at the Workstream were “is Native Gas available to the System”,”who has ownership of Native Gas” and “would Native Gas have Storage Capacity allocated to it”.

2.1.1 Workstream Views

The Workstream members expressed several disparate views. Most believed that Native Gas could flow from the Facility into the System, however it was suggested that Native Gas is not stored within Storage Capacity and therefore should not contribute toward the monitor level or reduction in Top Up determination, as Stored Gas.

The Workstream therefore felt that mirroring the current method of determining Top Up which excludes Native Gas, as Stored Gas, should continue to be applied.

2.2 The price of gas used in a gas transfer between the Top Up Manager and a Storage User.

The Modification Proposal detailed how the incentive for Storage Users to book Storage Capacity may no longer work. The initial proposal suggested replacing the gas transfer price with the greatest of 105% of WACOG or 105% of SAP plus injection charges.

After discussions at the Workstream meeting it was suggested that the alternative in the proposal did not ensure the incentive remained in place under all circumstances. Therefore three alternatives were developed as listed below: -

a) 105% of SAP, plus the injection charges of the appropriate Facility.

This measure was suggested in the Proposal based on the incentive for Transco to keep SMP within 105% of SAP and would therefore be an appropriate incentive to encourage the booking of Storage capacity. However, if SMP Buy was significantly different from SAP on a day then a situation could arise which could undermine the objective.

b) SMP, plus the injection charges of the appropriate Facility.

The transfer price would be set at Transco's highest price transacted on the day, or SAP whichever is the greater. This would ensure that there was no incentive for the Storage User to transfer gas from the Top Up Manager and flow it to improve their imbalance position on subsequent days.

c) Highest traded OCM price, plus the injection charges of the appropriate Facility.

The transfer price would be at the highest marginal price traded on the OCM by any counterparty on the transfer day. This would ensure that the price of gas would not prove to be attractive to Users and therefore maintain the incentive.

2.2.1 Workstream Views

The Workstream members had mixed views concerning which price would be most appropriate but the members agreed Users should be incentivised to book capacity early and remain independent of the Top Up Managers actions. Overall there was support for a "highest" price plus injection charges.

It was then a matter as to which price. No consensus was reached and Transco believe that the highest marginal price plus injection charges or 105% of WACOG would be the most appropriate price to generate such an incentive as to ensure that Storage bookings are made without a view to the actions of the Top Up Manager.

3. Conclusions of the Workstream

There is a meeting of the Planning and Security Workstream on Tuesday 14th November and, subject to comments received from the members, the Workstream believes that it has now reached the stage where Modification Proposal 0429 can proceed to consultation. In essence it has agreed that: -

* In response to the issue regarding the use of Native Gas in the determination of the Top Up requirements it is suggested that Native Gas be excluded from contributing towards Top Up determination. However, this may need to be addressed at a later date.

* In response to the issue regarding the gas transfer price incentive, it is suggested that the most appropriate price would be the highest traded price on the OCM on the day of the gas transfer plus the relevant injection charges. This would result in the transfer price of gas under Section P4.3 would be either 105% of Top Up WACOG or the Highest OCM traded on the day of the transfer plus the relevant injection charges.

* Agreement was reached on all other areas