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Transco, shippers and other interested parties

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Dear Colleague,

Modification 450 'Entry Overrun Charges on Transco nominations from Constrained LNG sites'

Ofgem has carefully considered the issues raised in modification proposal 450 *"Entry Overrun Charges* on *Transco nominations from Constrained LNG sites'* and has decided to direct Transco to implement the modification for the period up until 31 March 2002 because we believe that it better facilitates the relevant objectives of Transco's Network Code. Ofgem expects that the modification will be implemented with immediate effect. In this letter, we explain the background to the modification proposal, the nature of the proposal and give our reasons for making this decision.

Background

Under Standard Condition 13(1) of its PGT licence, Transco is obliged to plan and develop its pipeline system such that it can meet the peak aggregate daily demand that is only likely to be exceeded once in every 20 years. This is based on weather data derived from at least the previous fifty years and is known as Transco's 1 in 20 requirement.

Transco meets this requirement through a number of measures, including through constraining the use of shippers' gas at its Liquefied Natural Gas (LNG) storage facilities. Three LNG sites are currently classified as 'constrained': Isle of Grain, Avonmouth and Dynevor Arms. Transco constrains the rights of shippers that book capacity at these sites in two ways. Firstly, it sets minimum levels of gas that must be kept in store throughout the winter by shippers that book capacity at the sites. These monitor levels represent Transco's estimate of the volume of gas in store needed at different times of the year to ensure that the above 1 in 20 security standard can be met. Any shortfall between this monitor level and total shipper bookings is made up by Transco (acting as what is known as the Top-up Manager) purchasing 'constrained LNG top-up' gas, the costs of which are recovered from all shippers.

Secondly, Transco has the right to dictate the use of all, or part, of shippers' holdings at the constrained sites as if it were its own under certain circumstances. In particular, at the beginning of each storage year, Transco is required to produce a constrained storage statement that specifies the threshold demand flow at particular points on the network that may prompt it to exercise this right.

It is the potential financial effects of Transco's use of this second right that this proposed modification seeks to address. When Transco exercises this right, the nomination and the associated gas flow are treated as if they were initiated by the shipper whose gas is being 'constrained-on' by Transco. That is, the provision of the necessary NTS entry capacity is the responsibility of the storage user, and as a result, if the user holds insufficient capacity, it will be subject to overrun charges. Transco's right to use all of a shipper's gas as its own (under certain conditions) raises the possibility that the resulting flows may exceed the shippers NTS entry capacity holdings, and as a result overrun charges may be incurred.

In December 1999, Ofgem approved modification376 -'Overrun *Charges* on *Transco Nominations from Constrained LNG Sites'*- on a temporary basis until 30 April 2000. As a result of this modification, shippers were not charged for entry overrun charges at constrained LNG sites for deliveries in excess of a shipper's original booked entry capacity when the nomination giving rise to the delivery was as a result of Transco constraining-on that site. The temporary nature of the approval was because of the review process that Ofgem was carrying out regarding the LNG arrangements that were to be effective from May 2000 onwards.

Following this review, interim arrangements were put in place for the 2000/01 storage year, and have now been rolled-over to apply for 2001/02, while future arrangements for LNG storage are being considered as part of Ofgem's review of Exit Capacity, Interruptibles and LNG storage. The interim arrangements did not address the issue dealt with by modification 376, and as a result shippers have been potentially liable to entry capacity overrun charges as a result of Transco nominations at constrained LNG sites since May 2000 (when modification 376 expired). Proposal

In modification proposal 450, BGT has proposed reinstating the measures contained in modification 376. Entry over-run charges at constrained LNG sites should be zero in respect of gas constrained on by Transco where the constrained nomination exceeds a shipper's capacity as booked with Transco LNG without adjustment for any NTS entry capacity trades. This restriction is to ensure that a shipper cannot trade away LNG capacity and thus receive both trading income and the proposed overrun waiver.

Respondents' views

Three responses were received, all expressing support for the modification

One respondent commented that the temporary nature of modification 376 was due to the anticipation that this issue would have been considered within the context of Ofgem's consultations on LNG arrangements. It was also unfair, commented the

respondent, that a prudent shipper having made proper provision for its capacity needs was then penalised through circumstances beyond its control when it was constrained on by Transco, and that this could be viewed as a disincentive to book capacity at the constrained sites.

Implementation of modification 450 would remove the disincentive for shippers to book capacity at constrained sites, thus better facilitating the efficient and economic operation of

Transco's system. It should, said the same respondent, be implemented with effect from the beginning of the 2001/02 Storage Year, i.e. 1 May 2001.

Another respondent agreed that the liability to *face* overrun charges as a result of a Transco nomination was a disincentive to book capacity at a constrained -LNG site

One respondent made the point that a decision was required urgently as it might affect shippers bids in Transco LNG's Annual Storage Invitation, which closed on 4 April.

Transco's views

Transco comments that since the implementation of modification 376, a new entry capacity regime introduced under the Review of Gas Trading Arrangements (RGTA). This regime incentivises Transco to release adequate daily entry capacity and sets a zero reserve price at the constrained LNG sites. This new regime therefore significantly reduces shippers' exposure to entry costs (in th is case, those that arise as a result of a Transco nomination).

Transco acknowledges that the current arrangements might act as a disincentive for shippers to book capacity at constrained sites but comments that the scale of any disincentive is uncertain. Transco does point out, however, that insofar as the current arrangements might be seen as unfair, shippers are aware of this and are in a position to make appropriate arrangements to acquire a range of capacity entitlements.

Transco also made the point that it would be preferable if a decision were made prior to Transco LNG's Annual Storage on 4 April.

Ofgem's views

This proposed modification seeks to address the potential financial implications that result from the fact that storage users at constrained sites who have purchased sufficient NTS entry capacity for their own needs may become liable for entry overrun charges following a Transco nomination. This potential exposure to overrun charges may provide a disincentive for booking capacity at the constrained sites, and for holding stocks at those sites above monitor levels. In addition to the potentially distortionary effect that this may have on constrained storage bookings and usage, this disincentive has potential implications for Transco's use of the constrained sites, in that it has the potential to result in a requirement for CLNG top-up.

Ofgem believes that the appropriate level of entry overrun charges will need to be reviewed before the next storage year and in the light of Ofgem's review of exit capacity, interruption and LNG. We are currently in the process of consulting with the industry over new exit capacity, interruptions and LNG arrangements[1], and anticipate that any resulting changes to the LNG arrangements would be effective from April 2002 onwards.

Ofgem's decision

Ofgem has decided to direct Transco to implement this modification because we believe that it better facilitates the relevant objectives outlined in Standard Condition 7 of Transco's Gas Transporter's licence. In particular, we believe that it better facilitates the efficient and economic operation of the pipeline system as it reduces the potential need for CLNG top-up bookings, the costs of which are smeared across all shippers.

Ofgem expects Transco to implement this modification immediately and for it to be effective until 31 March 2002.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the number above, or Amrik Bal on 0207901 7074.

Yours sincerely

Stephen Smith
Director, Trading Arrangements

[1] The new gas trading arrangements: review of Transco's exit capacity, interruption and liquefied natural gas arrangements -a consultation document. Ofgem, March 2001