

**Draft Modification Report**  
**Treatment of Constrained Top-up Costs for Storage Year 2002/03.**  
**Modification Reference Number 0529**  
Version 2.0

This Draft Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

**1. The Modification Proposal**

Transco proposes continuation of the Constrained Top-up cost recovery arrangements implemented through Modification Proposals 0391 and 0451 for one further year, commencing 1st May 2002.

Modification Proposal 0529 was referred by the Modification Panel to the Planning & Security (including Storage) Workstream. At the January Workstream meeting discussion focussed on the new SO Incentives due to be implemented on 1 April 2002 and the effect, if any, these may have on transmission capacity arrangements. As it was noted that it was unlikely that full consensus on LNG/Demand Side Management would be reached by this date, Ofgem was requested to confirm whether the existing transmission capacity arrangements referred to in the Proposal would remain as present or change. Ofgem advised that the Proposal should proceed to consultation on the basis that the existing transmission capacity arrangements remain in place from 1 April 2002.

**2. Transco's Opinion**

Transco believes that its GT Licence obligation to meet peak transportation requirements should be funded appropriately. These requirements are met in part through the use of Constrained LNG. To the extent that shippers do not book sufficient Constrained LNG Services, Transco does so as Top-up Manager, to meet its Licence and Network Code obligations, and therefore should be funded. Top-up Neutrality is an established and appropriate method of funding. Transco supports extending the present cost recovery arrangements for a further period of one year.

**3. Extent to which the proposed modification would better facilitate the relevant objectives**

Under the terms of the GT Licence (Standard Condition 16 (2)), Transco's pipeline system must meet the aggregate daily demand which is likely to be exceeded only in 1 year out of 20 years. In certain geographical areas a combination of physical pipeline capacity and Constrained LNG is more economic and efficient than providing physical pipeline capacity alone. If this Modification Proposal is not implemented, Transco would be required to fund any shortfall in Constrained LNG bookings, whereas the alternative of pipeline investment could be included in the Regulatory Asset Base and earn an appropriate return. This could be regarded as a perverse incentive on Transco to invest in new pipeline capacity rather than utilise existing LNG assets. Such investments might conflict with Standard Condition 9 (a):

the efficient and economic operation by the Licensee of its pipeline system. Therefore implementation of this Modification Proposal would better facilitate this relevant objective.

**4. The implications for Transco of implementing the Modification Proposal , including**  
**a) implications for the operation of the System:**

As implementation of this Modification Proposal would continue the present arrangements, there would be no implication for the operation of the System.

**b) development and capital cost and operating cost implications:**

There are no development or capital cost implications. If this Modification Proposal were implemented, Transco would still be responsible for financing the initial purchase of storage services and gas. However, it would recover these costs within a year through Top-up Neutrality charges levied in respect of the December to March (inclusive) winter period.

**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:**

Recovery of Constrained Top-up costs as contemplated by this Modification Proposal is appropriate, for the reason given under "Transco's opinion" above.

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

Implementation of this Modification Proposal would have no effect on price regulation.

**5. 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**

Implementation of this Modification Proposal would reduce the level of contractual risk faced by Transco under the Network Code for Storage Year 2002/03, because it would remove the exposure to Constrained Top-up costs. These costs would arise to the extent that Users did not book and fill sufficient Constrained LNG to meet Transco's transmission support requirements.

**6. The development implications and other implications for computer systems of Transco and related computer systems of Users**

Transco is unaware of any development or other implications for the computer systems of Transco or for the related systems of Users.

**7. The implications of implementing the Modification Proposal for Users**

Users, as opposed to Transco, would bear any Constrained Top-up costs arising in Storage Year 2002/3. Any such costs would be shared in proportion to firm UDQO's over the

winter period of December 2002 to March 2003 inclusive, in accordance with the established Top-up Neutrality apportionment methodology.

**8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party**

It may be expected that Users would wish to pass on any additional costs to suppliers and consumers.

**9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal**

Implementation of this Modification Proposal would maintain the financing of Transco's licence obligations to provide transportation capacity sufficient for 1-20 peak demands.

**10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal**

Advantages:

- Allow Transco to recover costs not provided for under the price control;
- Avoid undue contractual risk to Transco;
- Avoid inappropriate investment signals and so discourage potentially uneconomic and inefficient investment in pipelines.

Disadvantage:

- Increase Users' exposure to Top-up neutrality charges.

**11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)**

Representations are now sought as part of this Draft Modification Report.

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

Implementation of this Modification Proposal is not required to facilitate compliance with safety or other legislation.

**13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence**

Implementation of this Modification Proposal would not change the methodology established under Standard Condition (4) 1 or (4) 5 of the Licence.

**14. Programme of works required as a consequence of implementing the Modification Proposal**

Transco would continue to be required to additionally calculate and invoice any Top-up Neutrality charges applicable to the winter period, consistent with established methodology and using existing systems.

**15. Proposed implementation timetable (including timetable for any necessary information systems changes)**

Transco proposes that this Modification Proposal should be implemented with effect from 1 May 2002.

**16. Recommendation concerning the implementation of the Modification Proposal**

Transco recommends this Modification Proposal should be implemented.

**17. Text**

*TRANSITION DOCUMENT, PART II*

*Amend paragraph 8.12 to read as follows:*

*"Section P: Top-up Storage*

*(1) Paragraphs (2) to (6) shall apply in respect of the Storage Years commencing 1 May, 2000, 1 May 2001 and 1 May 2002 ("relevant" Storage Years).*

***Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report***

Signed for and on behalf of Transco.

Signature:

**Tim Davis**  
**Head of Regulation NT&T**

Date: