

OFGEM DECISION LETTER No. 0723
"LNG Annual Storage Invitation terms into Network Code"
Version 1.0

Your Ref:
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Transco, Shippers and other interested parties

Dear Colleague,

Modification proposal 723, 'LNG Annual Storage Terms into Network Code'

Ofgem has carefully considered the issues raised in Modification proposal 723, 'LNG Annual Storage Terms into Network Code'. Ofgem is the office of the Gas and Electricity Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter. Has decided to direct Transco to implement the modification, as we believe that it will better facilitate the achievement of the relevant objectives of Transco's network code. Ofgem considers that this decision is also consistent with its wider statutory duties.

In this letter we explain the background to the modification proposal and outline the reasons for making our decision.

Background to the proposal

Since the 2000/01 Storage Year, Transco LNG Storage (TLNGS) has invited applications for Storage Capacity in each of the relevant Storage Facilities in accordance with network code section Z3.1. Since this initial Annual Storage Invitation (ASI) TLNGS has clarified elements of the LNG service in each subsequent ASI to ensure that potential users have all relevant information to allow them to bid for annual LNG Storage Capacity. As a result the 2004/05 ASI, which was issued on 1 March 2004, totalled 21 pages of both service terms and data. Additionally, current TLNGS users have inconsistent credit terms and there are errors in section Z text as a result of the implementation of modification 608.

The proposal

There are three elements to this proposal:

1. Incorporate standard ASI terms

It is proposed to incorporate the current standard ASI terms, ie the terms that have been replicated over several years, into network code section Z. Such service terms include Tanker Filling Arrangements, Low Cost Deliverability Overruns, Attribution of Value and Short Standby Charging Regime. The ASI would then be a 'data' document, consistent with a view expressed at Planning and Security including Storage workstream for only relevant information to be issued in tender documentation;

2. Creation of TLNGS credit terms

It is proposed to incorporate text into network code section Z, which states that should users apply for LNG Storage Capacity then they would be deemed to have accepted the TLNGS Credit Terms upon capacity application. Additionally, TLNGS would be obliged to make users aware of how to get access to the TLNGS Credit Terms and would discuss any modifications to such terms with relevant users; and

3. Correction of minor section Z errors

It is also proposed that minor errors contained in section Z, which have been identified over the last year since the implementation of modification 608, be corrected. These amendments include the addition of a reference to *Injectability* in Z3.5.1 and the correction to the *Injectability* compensation formula.

Respondents' views

There were five respondents to this proposal, of which three offered support and the remaining two gave qualified support. Specific comments were made on the following points:

1. Incorporation of standard ASI terms

Two respondents offered support for the incorporation of standard ASI terms into network code, with one commenting that this is administrative convenience and appears to have little or no impact upon commercial arrangements. The second believed that implementation would reduce the level of unnecessary administration and evaluation processes associated with the ASI.

In addition, one respondent raised a number of queries in respect of the proposed legal text. These included whether issues relating to the subdivision of the capacity of a bundled unit between the unbundled elements and the subdivision of the price paid between the unbundled elements were fully covered; whether the text should leave open the issue of whether users of tanker filling arrangements should pay prices set out in Transco's Licence or those in the relevant ASI; and that the standby conditions should be included within code rather than be presented in the ASI.

2. Credit terms

Comments offered in support of the proposal in respect of credit terms included that this would ensure consistent terms across the board and that they are also consistent with the methodology applied for setting credit arrangements for other services and as such appear reasonable. A respondent also suggested that as the terms would be referenced as an integral part of the network code common contract; these would be accessible to users to propose amendment of the conditions if thought necessary.

However, whilst supporting the proposal, one respondent expressed concern over the absence of a defined mechanism for the calculation of credit limits, suggesting that the resulting reduction in clarity might inhibit customer's willingness to enter into arrangements with TLNGS.

Two respondents offered qualified support for the modification proposal on the basis of concerns over the credit terms. In particular, they considered that the terms should be included in network code and therefore any changes covered by code modification procedures. Of these, one also suggested that credit limits should be determined by agreement between TLNGS and individual customers.

3. Correction of minor section Z errors

As above, one respondent considered that the modification would provide administrative convenience and appeared to have little or no impact on commercial arrangements.

Transco's view

Transco supported implementation of this modification proposal, offering the following comments:

1. Incorporation of standard ASI terms

Transco considered that the incorporation of standard ASI terms into network code would reduce the administrative burden upon TLNGS in creating the ASI and would expedite users' tender evaluation process.

In response to queries on the proposed legal text, Transco indicated that a user defined option for the subdivision of bundled unit capacity will continue to appear in the ASI; that the proposed legal text for Scottish Independent Undertaking (SIU) pricing reflects TLNGS obligations under licence and interim arrangements agreed with Ofgem in 1999; and that it considered that it would be inappropriate to define triggers for bringing the LNG Storage Facilities onto short standby, as this would impede TLNGS from refining triggers to reflect current market conditions such as knowledge on gas prices and the supply/demand match.

2. Credit terms

Transco believed that the additional creation of TLNGS credit terms would create consistency in all relevant users' credit terms, which would essentially reflect arrangements that are in place for

the current storage year. Additionally, Transco did not consider it necessary to seek 'agreement' in respect of the calculation of individual credit limits.

Transco considered that it would not be appropriate to include the credit rules in network code, highlighting that the proposal is consistent with the Code Credit Rules for transportation credit. Whilst recognizing the lack of formal consultation arrangements in respect of the rules, TLNGS indicated that it has always consulted in good faith with users and would continue to do so. In this respect, it stated that the rules would be amended such that any changes would only be made with effect from 1 April each year, and the revised rules would be notified to users with the ASI.

3. Correction of minor section Z errors

Transco noted that the correction of errors in section Z would ensure that the intent of modification 608 is applied.

Ofgem's view

Ofgem welcomes that improved clarity and consistency of arrangements that should follow from the incorporation of terms of ASI into network code. This improved clarity should assist the shippers in carrying out tender evaluation processes. Moreover, incorporation of these arrangements into the network code should reduce the administrative burden upon both shippers and TLNGS. Ofgem also agrees that some minor errors within section Z should be amended to prevent confusion and general lack of clarity.

It was apparent from responses that the key issue of this proposal was the treatment of credit terms. In particular, two respondents were concerned that the proposal did not have the effect of including the storage credit rules within the network code, and on that basis were only able to offer qualified support. Ofgem has previously indicated Arrangements for gas and electricity network operator credit cover – conclusions and proposals; February 2003. its view that it is inappropriate for credit rules to fall outside of the formal modification process and that they should be brought into the network code. Ofgem considers that this would deliver the same benefits of clarity and consistency that this proposal seeks to achieve; moreover it would provide additional accountability and add value to the decision making process more generally. Whilst it is open to any network code party to propose modifications, it is disappointing that Transco has not taken this opportunity to include storage credit arrangements within the network code, albeit their exclusion remains analogous with existing credit arrangements. Although Ofgem has no reason to doubt Transco's assertion that it has always consulted with users in good faith and would continue to do so, this is no substitute for robust and transparent governance, as provided by the network code modification rules.

Ofgem would agree with the respondent who suggested that there should be a defined mechanism for the calculation of storage credit limits. Although Transco states that it does not believe it is necessary to seek agreement with users in respect of individual credit limits, paragraph 9.1.2 a) of the proposed legal text would suggest that individual users can indeed discuss their storage credit limits with TLNGS. Individually agreed credit terms would seem to undermine one of the stated intentions of this modification proposal. Moreover, the agreement

of credit limits outwith a published objective mechanism could be reduce transparency and certainty, and make it more difficult for Transco to demonstrate that it is offering credit terms on a non-discriminatory manner. However, Ofgem is also mindful that this is merely a reflection of the current situation and will not be brought about by the implementation or otherwise of this modification proposal. It is therefore for Transco and network code users to determine how to address these concerns.

Notwithstanding its earlier comments on the status of the TLNGS credit rules, Ofgem notes the intention that any changes to those rules will only be made with effect from 1st April each year, and notified to Users with the ASI. Whilst Ofgem considers that such scheduling of changes can increase certainty and often reduce administration, these need to be balanced against the benefits of making improvements as and when they are identified. Ofgem would be concerned if such a rule could preclude or otherwise inhibit changes to the credit rules that could be intended by a network code modification proposal. However, Ofgem does not consider that this will be the case, as the network code will take precedence in this instance. Moreover, such a rule even within the network code itself need not preclude modifications being implemented outside of the intended cycle. It would simply require the proponent to include an amendment to the date rule as part of any future modification proposal. It would be incumbent upon that proponent to provide sufficient rationale for the credit terms being modified outwith the intended schedule and demonstrate that the benefits of doing so outweigh the loss of certainty etc. This flexibility may be necessary if Transco or any other party considers that modifications are necessary in light of the recent Ofgem paper on credit cover Best practice guidelines for gas and electricity network operator credit cover - Conclusions document; February 2005. , which includes a deadline of October 2005 for the implementation of certain arrangements pertaining to best practice.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to direct Transco to implement this modification as we consider that it would better facilitates the achievement of the relevant objectives of the Transco network code, as outlined under amended standard condition 9 of its GT licence and is consistent with statutory duties of the Authority. In particular, Ofgem considers that the incorporation of ASI terms into the network code will contribute to the efficient and economic operation by Transco of its pipeline system and facilitate competition between shippers.

If you have any further questions regarding this letter please do not hesitate to contact me on the above number or Bryony Sheldon on 020 7901 7174.

Yours sincerely,

Nick Simpson
Director, Modifications

