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Shippers, other interested parties
and Transco

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Dear Colleague,

Modification Proposal 0654 – “Notification of LNG Storage Duration”

Ofgem has considered the issues raised in modification proposal 654 – “*Notification of LNG Storage Duration*” - and has decided to direct Transco to implement the modification. 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

The network code requires that Transco LNG Storage (TLNGS) must issue its Annual Storage Invitation (ASI) by 1 March every year. The ASI details the availability of LNG capacity for which shippers can bid in pay-as-bid auctions at each of the LNG facilities for the storage year beginning 1 May.

The network code also requires TLNGS to offer a fixed 5 day LNG service at each facility. However, the space and deliverability levels detailed in the ASI might indicate that services of a different duration (other than 5 days) would be available.

In previous years, TLNGS, in line with its network code obligation to make available maximum storage capacity, has offered any space and deliverability in excess of the 5 day fixed service as “*Special Storage Capacity*” after the primary auction process.

The modification proposal

It is proposed that with effect from the Storage Year 2004/05, the network code reference to the fixed 5 day LNG storage duration be removed. The service duration would instead be referenced in the ASI and would be related to the available space and deliverability levels at the relevant facility.

Respondents' views

There were four responses to this modification proposal. Two respondents were in favour, one gave qualified support, while one did not support it.

The comments in favour concentrated on the view that service durations reflective of each facility's actual physical capabilities, as opposed to a fixed network code requirement, would lead to more efficient facility utilisation. Moreover, this was important given the withdrawal of capacity at Isle of Grain following its conversion to an import terminal.

One respondent could only give qualified support because it was concerned that TLNGS could use its increased discretion to act in an anti-competitive manner. It proposed limitations on TLNGS' ability to change the service duration, eg. only after a consultation and subsequent Ofgem approval.

The respondent who did not support this proposal thought that this proposal would introduce complexity and make the pricing of LNG services more difficult. However, it did suggest that there could be some merit for allowing TLNGS some freedom to vary service durations between 3 and 7 days.

Transco's Response

Transco is of the view that this proposal would offer extra flexibility to shippers, allow all capacity to be offered to the market in a more efficient manner, and would simplify the current arrangements.

Aside from the current network code rules that require TLNGS to offer maximum storage capacity, Transco points out that Ofgem would also have its competition powers in the event of any anti-competitive behaviour relating to the availability and pricing of LNG storage capacity.

Transco is in favour of the release of product information prior to the publication of the ASI but feels that its publication of capacity availability and Operating Margins' requirements is sufficient.

Transco also takes the view that it would be "*undesirable*" to reference the current service durations in the network code.

Ofgem's view

Ofgem supports moves that would increase the efficient utilisation of the LNG storage facilities, and this proposal would appear to be a step in that direction. It would seem sensible for TLNGS to offer the maximum storage capacity in one auction, as opposed to a 5 day service with Special Storage Capacity offered after the primary LNG auction.

Ofgem would, of course, be concerned if TLNGS started withdrawing capacity in an attempt to manipulate LNG storage prices. It is to that end that Ofgem held a consultation process earlier this year in the light of TLNGS' withdrawal of capacity ahead of the current storage year - we

note that this exercise drew few responses - although the current network code provisions permit TLNGS to review capacity levels without recourse to Ofgem or the industry.

Ofgem will continue to monitor the way in which TLNGS, as the monopoly provider of LNG storage services, determines: a) the maximum storage capacity referred to in Section Z of the network code; and b) the way in which product information is released to the market. This process would help establish the extent to which TLNGS might be engaging in behaviour designed to manipulate LNG storage capacity prices.

Ofgem's decision

Ofgem has decided to direct Transco to implement this modification because we believe that it better facilitates the relevant objectives in Transco's Gas Transporters licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the number indicated above or Kyran Hanks on 020 7901 7021.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Amrik Bal', written in a cursive style.

Amrik Bal
Gas Trading Arrangements