

URGENT Modification Report
Winter Injection Cost Allocation Based on User Daily Offtakes
Modification Reference Number 0660

Version 1.0

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.9.3.

Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.1.2 Ofgem has agreed that this Modification Proposal should be treated as Urgent because Ofgem has taken into account Transco's views regarding the potential security of supply concerns and the current top-up arrangements.

Procedures Followed:

Transco agreed with Ofgem (and has followed) the following procedures for this Proposal:

Issued to Ofgem for decision on urgency	24 October 2003
Proposal agreed as urgent	24 October 2003
Proposal issued for consultation	24 October 2003
Close out for representations	07 November 2003
Final report to Ofgem	17 November 2003
Ofgem decision expected	28 November 2003

1. The Modification Proposal

It is proposed in the event that on one or more Days the Top-up Manager determines a Winter Top-up Injection Requirement and in consequence injects gas into storage, the associated costs incurred by the Top-up Manager, including storage costs and net gas costs, would be recovered from Users in accordance with the following principles:

- The net costs arising from Winter Injections would be established over the Winter Period ("**Net Counter-Injection Costs**").
- A basis (expressed in kWh) would be determined over which such costs would be recovered ("**Recovery Quantity**").
- A unit charge would be derived from the Net Counter-Injection Costs and the Recovery Quantity ("**Counter-Injection Charge Rate**"). This charge rate would be applied to the individual User contributions to the Recovery Quantity.
- The approach to derive Net Counter-Injection Costs would allow for the fact that Top-up revenue, either resulting from acceptance of a Top-up Market Offer or, as a result of subsequent Top-up stock disposal, does not separately identify gas procured prior to the Winter Period and gas procured through Winter Injections. It is therefore proposed that, as such revenues in future winters might arise in respect of Top-up gas purchased ahead of the winter, the resultant revenues be attributed in

cost proportions in order to identify net costs arising from pre-winter and within-winter Top-up procurement.

- The Recovery Quantity would be set to equal the sum of all Users' UDQOs (but excluding UDQOs associated with storage injections) on Days where the Top-up Manager made Winter Injections.
- The Counter-Injection Charge Rate would be set as the Net Counter-Injection Costs divided by the Recovery Quantity

2. Transco's Opinion

Implementation of this Proposal would only lead to additional costs for Users in the event that insufficient provision was made to support gas demand consistent with a 1 in 50 winter condition.

The Transco assessment of this Proposal has focused on two of the relevant objectives: the requirement that the Network Code provides reasonable economic incentives for relevant suppliers to secure that domestic security standards are delivered and the promotion of competition between shippers and between suppliers.

The Network Code defines the Top-up regime and specifically the requirement for storage monitors and winter injection processes. They are designed to facilitate the maintenance of storage inventories consistent with satisfying gas demand in a winter of "1 in 50" severity. However this level of security can only be achieved with the appropriate provision and deployment of beach gas, storage capacity and utilisation, and interruption.

By not attributing costs associated with Top-up to Users Transco believes that the current arrangements are insufficient to ensure that gas provision and deployment will occur in a manner that is consistent with meeting the requirements associated with "1 in 50" conditions. Therefore Transco concludes that amendment of the Network Code is required to deliver incentives to encourage delivery of the established security standards.

The need for a Network Code amendment of this sort is particularly important at this time given the assessment of increased risk of winter injection being required this winter. This risk reflects a general tightening of the supply/demand position which might be expected to continue over the next two or three years. The risk of Winter Injections is also dependent upon a series of complex, but inter-related factors, including the availability of beach gas, the extent and anticipated deployment of User interruption rights and the utilisation of storage services.

Should this Proposal be implemented then Users would only face additional costs should Winter Injection occur. This would only occur should the industry make insufficient provision consistent with satisfying consumer demand in a 1 in 50 winter.

Transco considers that implementation of this Proposal would enable the Top-up mechanism to deliver the 1 in 50 security standard as originally intended. This is anticipated to lower the risk of Winter Injections being required.

Implementation of this Modification Proposal would apportion the costs of Winter Injections to Users in proportion to their demands over the Winter Period on days when Winter Injections were nominated by Transco. Transco believes that the incentive properties of this Proposal are inferior to those advocated in Modification Proposal 0659 "Winter Injection Cost Allocation Based on User Daily Imbalances".

However, Transco notes that many respondents have indicated that they could not have foreseen the basis of Modification Proposal 0659 at the time that they were making storage procurement decisions during this summer. This contention does not apply to this Proposal which is based upon the cost allocation methodology advocated in the Final Modification Report for Modification Proposal 0583 "Top-up Monitor Cost Recovery" which was supplied to Ofgem on 25th February 2003 and on which they decided upon on 15th August 2003. Transco believes that the issues given by Ofgem for rejection of Modification Proposal 0583 have been addressed by this Proposal. Transco also notes that many respondents expressed concern about the unlimited exposure that might apply to individual Users should Modification Proposal 0659 be implemented. Implementation of this (0660) Proposal would address this concern albeit at the risk of applying an arguably less well targeted attribution of costs.

Implementation of this Proposal would encourage demand-side management on Days where there was a risk of Winter Injections. Should this Proposal be implemented, Transco would seek to provide information to the industry to indicate the likelihood of Winter Injections to inform individual User actions. This would increase security of supply by encouraging the provision of such service. Implementation would further promote competition by encouraging Users to provide against a common 1 in 50 security benchmark.

This would contrast with the current situation where Users who provide for a lower level of security may be at a competitive advantage compared with those making adequate provision for consumer demand under 1 in 50 conditions. Therefore, Transco concludes that the implementation of the Proposal would better facilitate the relevant objectives of the Network Code.

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

Implementation of the Proposal would enhance the incentives on Users and Suppliers to procure sufficient supply and demand-side response capability in order to balance their supply/demand position over a severe winter. Implementation would be consistent with the licence obligation to provide provision of reasonable economic incentives for relevant Suppliers to secure that domestic customer supply security standards are satisfied as respects the availability of gas to their domestic customers.

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

Transco anticipates that implementation of this Proposal would enhance System security by providing additional incentives on the provision of adequate supplies and or demand management to support a 1 in 50 winter.

b) development and capital cost and operating cost implications:

Transco does not anticipate any major development and capital cost or operating cost implications. However, new systems and processes would be necessary to administer the calculation, billing and administration of the revised cost allocation.

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:

Transco would not seek recovery of any implementation costs. However any costs that do arise would contribute to operating costs and so would be shared with Users in accordance with the relevant SO incentive scheme.

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

Transco is not aware of any consequences that implementation of the Proposal would have 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

Transco anticipates that implementation of the Modification Proposal would reduce the level of contractual risk.

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

Transco does not envisage any major implications for computer systems. However Transco would envisage some changes to business processes to advise the industry of any incidence of Winter Injection and changes to systems may be necessary to deliver invoicing and subsequent processing of the resulting charges.

7. The implications of implementing the Modification Proposal for Users

Some changes would be envisaged within Transco's systems and Users may wish to consider some changes to their systems and/or business processes.

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

Transco believes that implementation of the Proposal may affect the value of storage services and other sources of supply flexibility that might be offered by these parties.

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

Transco is not aware of any consequences that implementation of this Modification Proposal would have on the legislative and regulatory obligations and contractual relationships of Transco and each User and non-Network Code Party. Implementation may influence gas sourcing arrangements and the extent of interruption and firm demand-side management invoked by Users.

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

Advantages:

- More appropriate attribution of Top-up costs.

Disadvantages:

- Additional costs for Users if their use of storage is inconsistent with that identified to deliver 1 in 50 security.

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

Sixteen representations were received from the following:

British Gas (BGT)	Against
BG Gas Services Ltd (BG)	Against
BP Energy (BP)	Against
Centrica Storage Ltd (CSL)	Against
Chevron UK Limited (Chevron)	Against
ConocoPhillips (UK) Limited (CPL)	Against
Corus UK Limited (Corus)	Against
EDF Energy (EDF)	Against
ExxonMobil Gas Marketing Europe Limited (ExxonMobil)	Against
PowerGen UK plc (PG)	Against
RWE Innogy (Inn)	Against
Scottish Power (SP)	Against
Scottish and Southern Energy plc (SSE)	Against
Shell Gas Direct (Shell)	Against
Statoil (UK) Gas Limited (Statoil)	Against
Total Fina Elf Gas and Power Limited (TFE)	Against

All respondents were against the Proposal although Chevron stated that it preferred this Proposal "over Mod 659". In general respondents felt that it would not enhance Users' incentives to procure sufficient supply and demand-side response in order to balance their supply/demand position during a severe winter or improve system security for this winter.

Adequacy of Present Incentives

Inn and EDF considered that existing regime incentives were sufficiently robust to ensure adequate storage bookings and therefore further incentives were not required. EDF believe "the right levels of commercial incentives are already placed on Shippers to help the GT meet its safety case and security of supply obligations. The fact that the monitor levels have never been breached before supports this argument." Inn contended that "Domestic suppliers (and their in house shippers) already have strong commercial incentives to ensure that they are not short of gas on high demand days and during periods of extended high winter demand. This is through their exposure to SMP Buy and Top Up Market Offer Prices."

CSL "accepted in principle that the existing balancing incentives are not likely to be sufficient to encourage shippers and suppliers to plan to 1 in 50 security levels, and that Transco's Network Code could be criticised for not fully providing "reasonable economic incentives for relevant suppliers to secure that the domestic supply security standards are satisfied"" and therefore "considers that some effort should be devoted to pursuing amended balancing incentives which would be known (or at least predictable) "on the day" and would be likely to provide incentives such that shippers and suppliers would seek to adhere more closely to the desired 1-in-50 criterion."

CPL stated that it could "not see what has changed that has considerably affected the regime, which requires Transco to now propose recovery of this cost from some/all System Users." EDF believed the right level of commercial incentives were already placed on Shippers and "This explains why storage has always been full, or nearly full going into winter and why Transco has never had to take Top-up Injection requirements."

Transco Opinion

Transco is concerned at the consequences of Users having a low perception of the likelihood of a severe winter. This perception might lead to them discounting this possibility within their supply/demand risk management processes. Therefore, the effect would be that the industry may be seeking to deliver system security at a lower level than that consistent with the application of current Network Code Top-up provisions. Unless the costs associated with remedying this lower level of security planning are attributed to the industry then the incentives on Users cannot be considered to be adequate.

Transco notes some of the representations have concluded that there is a possibility of Winter Injections being required this winter in order to maintain supply security. If this was proven to be the case then this would imply that the present incentives in place were inadequate to ensure that relevant Suppliers secure that domestic supply standards are satisfied, unless such actions resulted from the winter conditions being beyond the 1 in 50 condition.

Security of Supply Considerations

CSL, BGT, ExxonMobil, BP and EDF did not consider that the Proposal would enhance the security of the transmission system. BGT "believe that the top-up manager's counter-nomination is unlikely to result in any extra beach gas being delivered on that day." CSL did not consider that the Proposal "would materially affect overall system security for 2003/4" and "For any change to improve system security, the cost changes must create new incentives for shippers who have failed to provide sufficient sustained supply for a 1-in-50 winter requirement in a way whereby those shippers reactions will increase security". In CSL's view, "neither Modification would have this effect this winter." In response to this Modification Proposal and Modification Proposal 0660, BGT contended that " Neither of these Modification Proposals furthers any relevant objective, as in themselves they do not enhance system

security they simply seek to transfer what could be inefficiently incurred costs to other parties in an indiscriminate and arbitrary way."

Transco Opinion

Transco notes that certain representations suggested that there has been no security of supply issue and hence the present incentives are adequate. Absence of Winter Injections in recent winters may be primarily attributable to the mildness of recent winters which would, if repeated, reduce the probability of excessive storage depletion. Transco would also suggest that recent trends in beach gas delivery and use of storage, particularly at times when interruptible loads continue to offtake gas, as highlighted in Transco's Winter Operations Report 2003-4, may indicate an increased likelihood of Winter Injection to maintain the defined level of system security. Transco believes that implementation of this Proposal would further encourage additional beach deliveries and/or demand management, which should seek to preserve storage stocks thereby increasing the likelihood of maintaining security of supply, as the cost of the service would be attributed to Users.

Suitability of Proposed Change in Incentive Structure

Shell and CSL expressed concern that the Proposal would, in CSL's words, "act against the declared intentions" as the threat of additional charges would encourage more use of storage gas on certain days to ensure "long cash-out positions". Shell considered that this Proposal could lead to Users booking an inefficiently high level of storage in an attempt to prevent "the counter-nomination". "Besides promoting inefficient behaviour, this would be likely to undermine trading, and therefore effective competition between shippers."

Transco Opinion

Transco believes that implementation of this Proposal would promote alternatives to storage utilisation such as the use of demand-side reductions and increase flows at the beach and input flows through the Belgian interconnector. If, through whichever means, the system is long then Transco, as system balancer, will sell gas. It is likely that storage withdrawals (or reductions therein) will be the most responsive form of flexibility. As a result the net stored volume of gas would be greater than implied by the CSL response. Although Transco recognise that the Proposal would potentially incentivise Users to secure greater amounts of storage, it would only promote that which is sufficient to ensure that Users secure the 1 in 50 Severe Winter requirements. Therefore, implementation of this Proposal would be a positive development.

Compatibility with Transco's balancing incentives.

CSL, BGT and EDF questioned whether the proposed new charges were the best way to address the concerns detailed in the Proposal. CSL believed that "to increase system security for a future winter, changes to the balancing regime might best take the form of increasing market-generated SMP-buy values by predictable amounts." CSL also contended that "leaving Transco with a potentially large Top-Up exposure should help system security for 2003/4, because it is much larger than their "balancing incentive" and so should encourage them to allow/create high values for system prices which should help with the preservation of gas stocks in Rough early in the winter." BGT commented that "implementation of these Modifications would remove any incentive on Transco to minimise volume and price of Top-up gas purchased." and "would also give Transco ability to maximise benefits from their balancing incentives."

Transco Opinion

Transco believes that the daily cash-out regime should continue to reflect market conditions on the day. Transco does not consider that promotion of high SMPbuy prices as a policy objective is desirable or consistent with the Gas Transporter Licence obligations. Transco accepts that implementation of this Modification Proposal may, to an extent, promote higher market prices but this would be limited to only days where there is a prospect of a Winter Injection requirement.

The Network Code provides the basis for calculating Top-up quantities including the monitor requirements and the processes associated with Winter Injection. Should the Modification Proposal be implemented Transco would continue to have an incentive to accurately state the Top-up requirement.

Unpredictability of Charges

Shell stated that "Given that top up has not been used to date and there is little evidence to suggest that its use should not continue to be infrequent, ex post review of possible recovery of Transco's costs would appear to be a better approach." BGT, Statoil, TFE and ExxonMobil expressed concern over the uncertainty of, and Users' ability to mitigate their exposure to, the potential costs introduced by this Proposal. BGT stated that Users "would be exposed to unforeseen and unpredictable costs. "Statoil stated "shippers do not know the full cost of top up until May and therefore have no opportunity to reduce these costs through the use of gas flows other than storage." TFE state "Within 0660 few, if any, practicable mechanisms would exist to mitigate these charges in advance since they are based upon a shippers output on relevant days."

With regard to the recovery of the potential additional costs, both Shell and Inn made reference to Income Adjusting Events. Shell suggested that "Transco could use this mechanism to seek to recover some or all of its costs, providing that it can demonstrate that the costs of its use of top up were efficiently and economically incurred." Whereas Inn stated that if Top-up costs were to be transferred to Users then in their opinion they should "be treated as an income adjusting event under Transco's price control."

CPL stated that the "suggested charging methodology lacks transparency and is reliant on Transco "calculated" values." PG states " The proposals bring uncertainty to the market as the potential costs to Users would not be known during the winter and would be charged to Users after the winter period."

EDF referred to the effect of the implementation of the Proposal on SMPbuy prices stating that, if implemented, the Proposal "would further increase System Marginal Buy Prices as the costs of a Top-up winter injection are very high indeed and can be anywhere up to 99.9p/kwh which is not in the best interest of the whole industry as it is not cost reflective."

Transco Opinion

As detailed earlier, should this Proposal be implemented Transco would seek to provide additional information regarding Winter Injections to facilitate Users in mitigating their exposure. However, Users already face unpredictable charges in regard to their imbalance exposure and no doubt have put in place suitable mitigation for these charges. In conclusion, Transco believes that the potential effect of the absence of adequate incentives, in this area of the regime, is far worse than the unpredictability of charges within this Proposal

Appropriateness of Charge Focus

TFE, Shell, BG and CPL considered that any additional charges should be targeted to the Suppliers of domestic customers. CPL considered this appropriate since "the Top Up facility provides protection" for

these parties and TFE considered that "If nothing else, this would at least be logical with attempting to place incentives on those who's obligations it is to meet the relevant standards."

EDF also considered that the Proposal did not target costs effectively as it "does not target individual Shippers specifically who have not procured enough gas to meet their Licence obligations". Inn considered that the Proposal will discriminate against "Non-domestic" Users and those whose "portfolios do not require them to book storage."

BGT welcomed Transco's recognition that it was not appropriate to differentiate between domestic and non-domestic consumption. SSE "believe it is inappropriate to seek to address gas supply shortfalls by for example increasing the level of security provided by Top-Up and then targeting cost at downstream Users."

PG, in commenting on both Modification Proposals 0659 and 0660, stated that "Neither of the proposals can be accurately targeted at those who may have originally caused the problem."

Transco Opinion

Transco confirms that the Relevant Objective 9(1)(d) does apply to domestic security standards. It must, however, be recognised that Transco does not operate segregated pipe-line systems and System Balancing operates on a non-segregated basis. This implies that there are limits to the focus that can be achieved on "domestic shippers" in respect of reasonable incentives to ensure that domestic supply security standards are satisfied. The cost attribution described within this Proposal, although not perfect, would target those Users who utilise the System during the Winter Period. It is these Users who would be expected to make sufficient provision for supplies to meet their expected demands. The incidence of Winter Injections would indicate that as a group they had not made sufficient provision. Transco therefore believes that implementation of this Modification Proposal would provide a further incentive for Users to provide demand-side flexibility on Days of Winter Injection.

Implementation timetable

Inn, CSL, BGT, EDF, CPL and Shell opposed the proposed implementation date. Inn stated that "If either of these modification proposals are accepted shippers will, at this point in the current Gas Year and Storage Year, have limited ability to mitigate their exposure to any winter injection costs that may arise, as interruption contracts for the winter will already be in place and storage bookings will have been made (or not as the case may be)." CSL considered that "unless the mechanism and the likely effects are known about 6-9 months before the winter.....Users would be unlikely to modify their winter positions" and "recommends that the industry should urgently consider suitable changes which could be implemented from October 2004, with the aim of agreeing any changes by March 2004."

Transco Opinion

Whilst recognising that certain storage and demand-side contract arrangements are not open to change in respect of this winter, Transco still believes that the changes in the incentive structure might promote different deployment strategies that might be consistent with avoidance of Winter Injection requirements. Additionally, implementation might trigger increases in supplies to the System from offshore or through the interconnector. It also believes that some additional demand-side response could be encouraged.

Whilst the timescales associated with this Proposal have been compressed, there has been extensive discussion of these issues within the NT&T Workstream and its predecessors. Transco raised Modification Proposal 0583 in November 2002 which sought to address the same issues. This was

rejected in August 2003. Users would therefore have been aware of the content of this Proposal when assessing their storage requirements at the time of the Annual Storage Invitation. Since this date, Transco has sought to engage the industry in enhancing the regime to better deliver appropriate incentives and additionally in October 2003, Transco published its Winter Operations Report 2003-4, which also raised similar issues. Transco therefore considers that sufficient debate has taken place within the industry to form a view on the essential elements within this Proposal, which to a large extent were considered within Modification Proposal 0656 and the NT&T Workstream.

Process issues

Inn stated that "Only two months after Ofgem rejected a proposal for shippers to be exposed to the cost of Top Up therefore, Transco have again raised proposals seeking to effect this. Because of their decision to use more realistic beach supply information to adjust the Storage Monitors they have increase the potential costs that are likely to be occurred and appear to be using this as the basis for claiming that the resulting incentives are now stronger. As such if these costs are now passed on to shippers, security of supply will miraculously be enhanced." Also "There was no suggestion in Transco's Top Up statement published in May this year, that the calculation of the Stored Gas Requirement and Storage Deliverability Requirement under section P.2.1.2. of the Network Code should be based on a more realistic assessment of beach supply information, or that they should reflect other concerns raised by NGT in the Winter Operations Report.

Had this been the case the Stored Gas Requirement and Storage Deliverability Requirement would both have been higher than the figures published, which may have resulted in there being an aggregate top-up deliverability requirement and/or an aggregate top-up space requirement under section P 2.2.1 (iii) and (iv) of the Network Code. In such circumstances the Top Up Manager would have to apply for Storage Space and/or Storage Deliverability no later than 31st October in accordance with section P.2.3.1 of the Network Code. In the event Uncommitted Storage Space and/or Uncommitted Storage Deliverability was not available to satisfy all this potential requirement, Transco would be obliged under section P 2.6.1. (iii) of the Network Code to notify shippers of revised security levels that will apply this winter."

Corus expressed concern that "Unless their is full disclosure of information relating to Transco's Top-up management role over the long term together with its future projections for storage we do see how the market should be fundamentally more efficient than Transco in carrying out this function."

Transco Opinion

Transco would wish to refer to the reasons for Ofgem's rejection of Modification Proposal 0583.

Firstly, Ofgem expressed the continued view that security of supply concerns are best expressed "through a combination of incentives and signals created by competitive markets and effective regulation, e.g. reforms to the storage market and the network code arrangements that provide shippers with strong commercial incentives to balance their inputs and off-takes."

Transco believes that implementation of this Modification Proposal would move the regime forward towards these objectives.

Secondly, Ofgem in reviewing its reason for rejection of Modification Proposal 0472, stated that "while consideration has to be given to Transco's potential top-up liability given the requirements of its Safety Case, it would be inappropriate to permit Transco to recover inefficiently incurred top-up costs because such costs would be passed on to customers."

Transco believes that this Proposal addresses Winter Injection requirements that are consistent with delivery of 1 in 50 security. The procurement of this gas would be made taking account of the Top-up Manager's view of within day gas values and cashout exposures. Therefore the procurement activity would be efficient and Transco will be seeking greater discretion in respect of Top-up disposals to ensure that all such costs might be considered efficient. Therefore, it would continue to be incentivised to efficiently incur the costs associated with Winter Injection and in any event Transco would be mindful of its Licence obligation of efficient and economic operation of the pipe-line system.

Thirdly, Ofgem referred to the Top-up process enhancements embodied within Modification Proposal 0504 and expressed the view that "This modification provided Transco with greater flexibility in dealing with gas stocks falling below the monitor level during the winter (as envisaged by modification proposal 583). Transco has yet to indicate the subsequent impact of this modification on the need to make a winter top-up injection."

Transco believes that recent information provided by Transco in its Winter Operations Report 2003-4 and in its Top-up Monitors for Winter 2003/4 indicate that Winter Injection might be required prior to 1 February 2004. The Winter Injection flexibility provided by the implementation of Modification Proposal 0504 only applies to the months of February and March in each Gas Year.

Fourthly, Ofgem expressed the view that Modification Proposal 0583 had been amended to a material and significant degree after responses had been received. It therefore stated that changing "the focus of any charges away from storage withdrawal activity to all system users would have been an important factor as it would affect the commercial considerations of parties who had decided not to respond to the original modification (as they thought it did not affect them)." Transco believes that this Modification Proposal 0660 is clear in the way charges would be focussed and has made no changes to the Proposal as originally worded. Therefore, whilst Transco notes that Users have not supported the Proposal they have been afforded an opportunity to consider and respond to it.

Transco recognises the effect of adopting a more realistic beach supply assumption, but would wish to confirm that its present set of assumptions in regard to the setting of monitor levels would not have led to a pre-winter Top-up requirement.

Use it or Lose it (UIOLI)

BG commented that "The Use it or Lose it rules relating to Rough inhibit what Transco are seeking to do and these should explicitly be tackled. Our suggestion would be to have trading of withdrawal and injection capacity that would not be subject to UIOLI rules, hence sterilising both the primary activity and restricting the opposite position."

Transco Opinion

Transco is discussing this aspect with Storage Operators and views this to be an issue about the efficiency of the Winter Injection process. Transco will be seeking changes to promote improved efficiency independent of the Modification Proposal.

Transportation use of Top-up

BGT stated that "It is by no means clear that Top-up is applied solely to address issues of supply shortfalls. Failures of the Transportation System could also be cause. These proposals do not address this potential in anyway and simply enable Transco to avoid the costs even where the cause is a failure within their own system."

Transco Opinion

Top-up does not provide a back-up to address failures of the transportation system.

Alternative methods of funding.

EDF stated that "We believe that the best way to address Transco's concerns with being liable for Top-up Injection costs lies within their price control. This is because its an event that is unlikely to happen, unless in a 1 in 20 or a 1 in 50, and Transco should have some provision in their allowed revenue for this."

Transco Opinion

No allowance has been made for Top-up funding within the present price control. This Proposal, if implemented, would improve upon the current situation and ensure that the Network Code provides the required incentives in this area. Transco believes that Network Code incentives should be sufficient to eliminate the necessity of Top-up bookings, procurement and Winter Injections. The supplemented incentives that would result from implementation of this Proposal might decrease the extent, or reduce the likelihood, of Winter Injections.

Cost recovery

Shell stated that the Proposal "would result in all of the costs of top up being passed to shippers" which it does not consider "to be either reasonable nor economic."

Transco Opinion

If this Modification Proposal were implemented, Transco would continue to face any costs associated with pre-winter booking of Top-up and any financing costs associated with winter injection.

Charge governance

Shell stated that the Proposal "will introduce a charge which will be opaque, difficult to model, unpredictable with key parameters subject to adjustment by Transco without prior consultation. We welcome further explanation on how this satisfies the requirements in the licence." Shell suggested that if Transco was to be allowed to recover Top-up costs "then this should only be done once Transco has brought forward proposals on how top up requirements, their development, underlying assumptions, publication etc are to be governed."

Transco Opinion

Transco has provided the Workstream with information on how the present set of Top-up monitors were calculated and, following implementation, would provide to Users ongoing information from which they would facilitate estimation of their exposure. Following implementation, Transco would provide ongoing supporting information to enable Users to validate their invoice charge items arising from the attribution of Winter Injection costs.

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

Implementation is not required to enable Transco to facilitate compliance with safety or other legislation but would further enhance incentives to secure the provision of supplies to support the 1 in 50 security standard.

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 is not required having regard to any proposed change in the methodology established under Standard Condition 4(5) of the statement, furnished by Transco under Standard Condition 4(1) of the Licence.

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

Systems and process developments would be necessary to deliver charges to support the associated charge derivation and billing processes.

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

Transco recommends that the Proposal be implemented on the 1st December 2003.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of this Proposal or Modification Proposal 0659

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This Modification Report contains Transco's proposal to modify the Network Code and Transco now seeks direction from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

DRAFT LEGAL TEXT

SECTION P: TOP-UP STORAGE

Add new paragraphs 3.4.8, 3.4.9, 3.4.10, 3.4.11, 3.4.12, 3.4.13, 3.4.14 and 3.4.15 to read as follows:

"3.4.8 Where the Top-up Manager determines there is a Winter Top-up Injection Requirement for a Storage Facility Type in respect of a Day pursuant to paragraph 3.4.1, the Top-up Manager shall notify Users by UK Link Communication by not later than 21:00 hours on the Preceding Day.

3.4.9 Where the Top-Up Manager has given notice under paragraph 3.4.8 and a User or Users withdraw gas from a relevant Storage Facility ("**relevant facility**") on a relevant Day, paragraph 3.4.10 shall apply.

3.4.10 Where this paragraph applies:

- (a) all Winter Injection Costs, which but for this paragraph 3.4.10 would or may be Top-up Costs, shall not be Top-up Costs for the purposes of paragraph 6;
- (b) all Winter Injection Revenues, which but for this paragraph 3.4.10 would or may be Top-up Revenues, shall not be Top-up Revenues for the purposes of paragraph 6; and
- (c) all Net Winter Injection Costs shall (if positive) be payable by Users to the Top-up Manager and (if negative) be payable by the Top-up Manager to Users, in each case in accordance with the provisions of paragraph 3.4.12.

3.4.11 For the purposes of paragraph 3.4.10:

- (a) the "**Winter Injection Costs**" are the total amounts payable by the Top-up Manager in respect of Winter Injection Gas injected on a Day:-
 - (i) under or in respect of the Top-up Gas Procurement Arrangements;
 - (ii) by way of Transportation Charges in respect of Storage Connection Points and other System Entry Points;
 - (iii) under Section F4 in respect of Balancing Charges;
 - (iv) by way of Storage Capacity Charges in respect of Storage Capacity in Top-up Storage Facilities;
 - (v) by way of Storage Injection Charges in respect of injection to Top-up Storage Facilities;
 - (vi) by way of Storage Withdrawal Charges in respect of withdrawal;
 - (vii) pursuant to any other provision of the Code by which (as User) the Top-up Manager is required to make any payment;
- (b) the "**Winter Injection Revenues**" are the total amounts realised by the Top-up Manager in respect of Winter Injection Gas injected on a Day:-
 - (i) in respect of Top-up Storage Transfers under paragraph 4;

- (ii) under Section F4 in respect of Balancing Charges;
- (iii) subject to paragraph 6.1.4, by way of Market Balancing Action Charges in respect of Top-up Market Offers made:
 - (1) for Days in the Winter Period; and
 - (2) for Days not in the Winter Period.
- (iv) in respect of any Storage Withdrawal Nomination in respect of Winter Injection Gas made by it as Transferor Storage User;

provided that, where the Top-up Manager realises revenues on a Day, and it is not possible to determine whether such revenues relate to Winter Injection Gas or other gas procured by the Top-up Manager, a proportion of such revenues shall be deemed to be in respect of Winter Injection Gas on the basis of the proportion which Winter Injection Gas procured on that Day bears to the total quantity of gas (including Winter Injection Gas) procured by the Top-up Manager on that Day; and

- (c) the “**Net Winter Injection Costs**” are the total Winter Injection Costs less total Winter Injection Revenues (and shall be positive if Winter Injection Costs exceed total Winter Injection Revenues and negative if Winter Injection Revenues exceed total Winter Injection Costs).

3.4.12 Where:-

- (a) Net Winter Injection Costs for the Winter Period are positive and are accordingly payable by Users to the Top-up Manager pursuant to paragraph 3.4.10(c), each relevant User shall pay to the Top-up Manager a charge (“**Winter Injection Incentive Charge**”) calculated in accordance with the provisions of paragraph 3.4.13 below; and
- (b) Net Winter Injection Costs for the Winter Period are negative and are accordingly payable by the Top-up Manager to Users pursuant to paragraph 3.4.10(c), the Top-up Manager shall pay to each relevant User a charge (“**Winter Injection Incentive Charge**”) calculated in accordance with the provisions of paragraph 3.4.13 below.

3.4.13 In respect of each Day for which a Winter Injection Incentive Charge is payable, it shall be calculated in respect of each relevant User as being the amount of the Net Winter Injection Costs for the Day divided by the sum of all relevant UDQOs for the Day multiplied by the sum of that relevant User’s relevant UDQOs for such Day.

3.4.14 For the purposes of paragraph 3.4.13, “**relevant User**” and “**relevant UDQO**” shall have the meanings given to such terms in paragraph 6.4.2.

3.4.15 Top-up Winter Injection Incentive Charges shall be invoiced and are payable in accordance with Section S.

Signed for and on behalf of Transco.

Signature:

Mike Calviou
Commercial Frameworks Manager
NT & T

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0660**, version **1.0** dated **17/11/2003**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **1.0**.

Signature:

Process Manager - Network Code

Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.