

URGENT Modification Report
Winter Injection Cost Allocation Based on User Daily Imbalances
Modification Reference Number 0659

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	14 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' negative daily imbalances on Days where the D-1 Demand Forecast exceeded a predetermined demand threshold. ("Top-up Relevant Days Threshold").
- This Top-up Relevant Days Threshold would be set to equal the 95% of maximum daily supply (ie beach gas plus Continental Interconnector import) identified within Transco's annual Top-up statement.
- The Counter-Injection Charge Rate would be set as the Net Counter-Injection Costs divided by the Recovery Quantity.

Transco believes that setting the Top-up Relevant Days Threshold to 95% of maximum daily supply would mitigate the risk to individual Users arising from the possibility of a very high Counter-Injection Charge Rate whilst at the same time providing a sufficiently strong incentive.

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 will only face additional costs should winter injection occur which will only occur should the community make insufficient provision consistent with satisfying consumer demand in a 1 in 50 winter.

Transco considers that implementation of this Proposal will 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 would seek to better target winter injection costs to those that had not made sufficient provision. Thus implementation would better encourage Users to provide against 1 in 50 security standard. This would assist promote competition by encouraging individual Users to procure against a common 1 in 50 severity 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 will better facilitate the relevant objectives of the Network Code and recommends Ofgem to direct implementation.

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 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.

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 will not seek recovery of any implementation costs, however any costs that do arise will contribute to operating costs and so will 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.

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 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 community 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 (ExxonMob)	Against
PowerGen UK plc (PG)	Against
RWE Innogy (Inn)	Against
Scottish Power (SP)	Qualified Support
Scottish and Southern Energy plc (SSE)	Against
Shell Gas Direct (SGD)	Against
Statoil (UK) Gas Limited (Statoil)	Against
Total Fina Elf Gas and Power Limited (TFE)	Against

Fifteen respondents did not support the Proposal. One offered qualified support. In general, those not in favour of the Proposal felt that it would not enhance Shippers' 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 impacting upon market prices. This perception might lead to them discounting this possibility within their supplies planning. Therefore, the effect would be that the industry may be seeking to deliver system security at a lower level than that implied by 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 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.

Suitability of Proposed Change in Incentive Structure

SGD 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". Inn echoed CSL's concerns by suggesting that the Proposal "creates the perverse incentive that on days where Transco counter injection takes place, if a shipper is likely to be short they will be incentivised to take more gas out of storage to mitigate their potential exposure to these costs. The effect of this will be to exacerbate the situation, which could have a spiralling effect."

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 and SGD responses. 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.

Transco would wish to point out that the Network Code provides the basis for calculating Top-up quantities including the definition of the monitor 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."

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 SMP_{buy} 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

Users who have flexibility adequate to support their consumer demand associated with a 1 in 50 severe winter would not experience any additional uncertainty due to the implementation of this Modification Proposal. Indeed, any User who has secured against a 1 in "n" winter but then experiences a less than 1 in n would not incur any additional exposure.

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. Even under existing Network Code provisions, the impact of acceptance of a Top-up Market Offer would not be confined to Shippers with a domestic supply portfolio. However, it could be argued from the load profile associated with domestic Supply Points, that the Shippers concerned would have high requirements for storage or demand-side interruption and would have negative imbalances if such provisions were not made. Such requirements would contrast with Shippers specialising in certain sections of the I&C market where a less weather sensitive profile would justify base-load supply provision which would reduce the exposure to SMP_{buy} prices set at the Top-up Market Offer Price. Transco therefore believes that implementation of this Modification Proposal would provide a further incentive for the relevant Suppliers to secure supply security and where this incentive would impact on non-domestic Shippers this would not be in conflict with the relevant objectives.

Associated with this issue are considerations of licence obligations for Suppliers and Shippers in respect of security of supply. The respective licences clearly set out the obligations in respect of transportation conducted outside the Transporters' Network Codes. However, where transportation of Shippers' gas is

under Network Code terms, this direct obligation is replaced by the Network Code relevant objective summarised in the Modification Proposal which seeks to achieve the same level of supply security.

Charging Mechanism

BGT considered that the charging mechanism "is arbitrary and do not correctly target costs back to the cause". In reference to the Top-up Relevant Days Threshold, TFE were not convinced that the proposed incentives "are best achieved by using the proposed indicator" and observed that "no justification is made within the proposal for using only 95% of maximum daily supply". BG expressed concern that the proposed cost allocation methodology based on imbalance quantities could lead to, "in extremis, all the costs on a day" being "borne by a shipper who was 1kWh short."

Transco Opinion

It is impossible to precisely target costs. It is therefore necessary to derive an approach that has benefits that exceed the limitations and weaknesses. We believe that an approach based on a threshold affords opportunity to deliver an appropriate compromise. The responses in respect of the Threshold Level in some ways reflect the debate within the NT&T Workstream. Setting a level equivalent to 100% beach gas plus maximum interconnector importation was suggested initially as this demand level is normally associated with use of storage and possibly application of demand-side reduction. Transco has, however, considered the view that a lower threshold might be applicable to reflect more recent experience in regard to both the actual deliveries achieved at beach terminals and the utilisation of seasonal storage facilities. For this reason the Modification Proposal is based upon a 95% (Beach + Interconnector) threshold. Setting such a threshold would reduce the risk identified of Users with a very small imbalance facing a disproportionately high cost. However, this should be set against the lack of focus that would apply in the event of a very low threshold level.

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 mirrored within Modification Proposal 0656, the forerunner of this Proposal.

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 there 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, eg. 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 meet the above 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 if this Proposal were implemented 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 0659 is clear in the way charges would be focussed and has made no changes to the Proposal as originally worded.

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 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. Whilst this position may change in the future, this Proposal is required to improve upon the current situation and to 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, particularly if these were supplemented by implementation of this Proposal.

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 be able to facilitate estimation of their exposure. Following implementation, Transco would provide ongoing supporting information to enable Users to validate their invoice.

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

No programme of works is required.

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

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

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 For each Winter Period during which the Top-Up Manager has determined there is a Winter Top-up Injection Requirement for one or more Storage Facility Types in respect of one or more Days pursuant to paragraph 3.4.1, and has injected gas ("**Winter Injection Gas**") into such Storage Facility or Storage Facilities pursuant to paragraph 3.4.3, paragraph 3.4.9 shall apply.

3.4.9 Where this paragraph applies:

- (a) all Winter Injection Costs, which but for this paragraph 3.4.9 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 3.4.9 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 3.4.11.

3.4.10 For the purposes of paragraph 3.4.9:

- (a) the "**Winter Injection Costs**" are the total amounts payable by the Top-up Manager in respect of Winter Injection Gas injected during a Winter Period:-
 - (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 during a Winter Period:-
 - (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, 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 bears to the total quantity of gas (including Winter Injection Gas) procured by the Top-up Manager during the Storage Year in which the Winter Period in question falls; 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).

3.4.11 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 3.4.9(c), each relevant User shall pay to the Top-up Manager a charge (“**User Winter Injection Incentive Charge**”) calculated in accordance with the provisions of paragraph 3.4.12 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 3.4.9(c), the Top-up Manager shall pay to each relevant User a charge (“**Top-up Manager Winter Injection Incentive Charge**”) calculated in accordance with the provisions of paragraph 3.4.13 below.

3.4.12 In respect of each Winter Period for which a User Winter Injection Incentive Charge is payable, the User Winter Injection Incentive Charge payable by each User shall be calculated as the sum of:-

$$UWIC = AUNI * UWICR$$

Where:-

UWIC is the User Winter Injection Incentive Charge payable by the User in question;

AUNI is the sum of that User’s negative Daily Imbalance (if any) on each Relevant Winter Injection Day; and

UWICR is the User Winter Injection Charge Rate.

3.4.13 In respect of each Winter Period for which a Top-up Manager Winter Injection Incentive Charge is payable, the Top-up Manager Winter Injection Incentive Charge payable to each User shall be calculated as the sum of:-

$$TWIIC = AUDQO * TWICR$$

Where:-

TWIC is the Top-up Manager Winter Injection Incentive Charge payable to the User in question;

AUDQO is that User's Aggregate UDQO; and

TWICR is the Top-up Manager Winter Injection Charge Rate.

3.4.14 For the purposes of paragraphs 3.4.12 and 3.4.13:-

(a) a "**Relevant Winter Injection Day**" is a Day during the Winter Period in question on which the Forecast Total System Demand exceeds 95% of the maximum daily supply (as determined in accordance with Section O2.2) at 14.00 hours on the Preceding Day;

(b) the "**User Winter Injection Charge Rate**" is an amount calculated as:-

$$UWICR = NWIC / RQ$$

Where:-

UWICR is the User Winter Injection Charge Rate;

NWIC is the Net Winter Injection Costs for the Winter Period in question; and

RQ is the sum of all Users' negative Daily Imbalances on each Relevant Winter Injection Day;

(c) the "**Aggregate UDQO**" of a User is sum of the UDQOs of that User on each Day of the Winter Period; and

(d) the "**Top-up Manager Winter Injection Charge Rate**" is an amount calculated as:-

$$TWICR = NWIC / TUDQO$$

Where:-

TWICR is the Top-up Manager Winter Injection Charge Rate;

NWIC is the Net Winter Injection Costs for the Winter Period in question; and

TUDQO is the sum of all Users' UDQOs on each Day of the Winter Period;

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

Add new paragraph 8.12(7) to Part II of the Transition Document to read as follows:

"(7) For the purposes of Storage Year 2003/4, the Winter Period to be used for the purposes of paragraphs 3.4.8 to 3.4.14 of Section P shall be deemed to be the period from the Day following the implementation of the Modification that gave effect to this paragraph until and including 30th April 2004."

Signed for and on behalf of Transco.

Signature:

Mike Calviou
Head of Commercial Frameworks
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 **0659**, version **1.0** dated **14/11/2003**) 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.