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15 August 2003

Dear Colleague,

Modification Proposal 583 – “Top-up Monitor Cost Recovery”

Ofgem has considered the issues raised in Modification Proposal 583 – “*Top-up Monitor Cost Recovery*” – and has decided not to direct Transco to implement the modification. In this letter, we explain the background to the modification proposal, the nature of the proposal and give our reasons for making this decision.

Background

Transco’s GT licence requires it to operate a system that can meet the peak aggregate daily demand that is only likely to be exceeded once in every twenty years taking into account weather derived from at least the previous fifty years through a number of measures.

In using storage facilities to help meet these obligations, Transco sets a “monitor level” at long, medium and short duration facilities (as defined in Section P of the network code) respectively. These opening monitor levels represent Transco’s estimate of the volume of gas in store needed at different times of the year to ensure that the above security standards can be met.

Transco's Safety Case requires it to make good any shortfall between this monitor level and total shipper bookings by purchasing "national top-up" gas in its role as the "Top-up Manager". Even where Transco has had to do this ahead of the winter, shipper withdrawals during the winter period could cause stocks of gas in store to fall below the monitor levels, could precipitate further action on the part of Transco.

The modification proposal

Modification proposal 583 originally proposed that where Transco in its role as the Top-up Manager identifies such a "winter top-up" injection requirement, it would notify this to all users. Following such notification, if a user were to make any subsequent storage withdrawal nomination, the net costs of any counter storage injection made by the Top-Up Manager in compliance with the network code and Safety Case would be recovered from that user. This notification would be recovered from that user. This notification would be withdrawn if the monitor level subsequently fell below the amount of gas-in-storage.

The costs expected to be incurred by the Top-Up Manager to be recovered from the user would be:

- Cost of gas purchased on the day for injection into the Storage Facility(ies) concerned;
- Costs of all services procured by the Top-Up Manager in order to make the injection and to store the gas; and
- Any additional costs in withdrawing that gas from the Storage Facility(ies) under network code disposal arrangements.

It is suggested that all income, after allowing for financing costs, from the subsequent disposal of that gas would be offset against the costs summarised above.

Following representations in response to the above, Transco amended the proposal so that the net costs resulting from counter-injections by the Top-Up Manager are recovered from *all* system users on the basis of their firm demand on the Gas Day.

Respondents' views

Five responses were received in response to this modification proposal and all were against the proposal.

Comments were made questioning the extent to which the proposal would better facilitate the relevant objectives, and also that the proposal would result in some storage customers being unfairly penalised. It was also suggested that this proposal could have a negative impact on the value that shippers place on storage as it would discourage the withdrawal of gas at a time when shippers would normally expect to withdraw gas.

A widespread view was that this proposal was unfair because all LNG customers on the day would in part have contributed to the monitor level having been breached, not just one party. The proposed notification period of 21:00 hours on the preceding Gas Day was regarded as insufficient by one respondent, as was the fact that the modification appeared to question the fact that it had been established that the top-up obligation should reside with Transco.

One respondent commented that at Rough the storage operator normally makes available interruptible withdrawal capacity up to the level of the facility's physical capacity plus any injection nominations received (and this was probably the case at other storage facilities). Therefore, an injection nomination from Transco would have the impact of allowing greater shipper withdrawal nominations to be accepted.

It was also suggested that Transco could explore other ways to encourage the required shipper behaviour such as contracting ahead with a shipper not to withdraw gas in certain circumstances.

Transco's Response

Transco supports implementation of this modification. Transco believes that users would as a result be incentivised to seek alternative means of maintaining a supply/demand balance on the Gas Day, thus retaining quantities of gas-in-store at monitor levels.

Transco suggested that the amended modification that would see charges imposed on all system users on the day, as opposed to the storage customer causing the monitor level to be breached, should reduce the level of uncertainty faced by

storage customers and better target costs at gas flows on the day. In Transco's view, this should ensure that the cost of the top-up obligation does not fall on Transco alone and that the value of storage is not diminished.

Transco also commented that other alternatives to the present top-up arrangements were likely to prove more expensive than implementation of this modification.

Ofgem's view

Ofgem continues to believe that security of supply concerns are best addressed 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's purchases of top-up could have a distortionary effect on, for example, shippers' purchases of storage.

In line with such a view, we commented in our letter rejecting modification proposal 472 - "*Restoration of Funding for National Top-up*" - 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.

In that context, it should be noted that in August 2002, Ofgem approved modification proposal 504 - "*Top up Process Enhancements*". This modification provided Transco with greater flexibility in dealing with a 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.

Moreover, modification proposal 583 was amended to a material and significant degree after responses had been received. 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).

Ofgem's decision

Ofgem has decided not to direct Transco to implement this modification because we believe that it will not better facilitate the relevant objectives in Transco's Gas Transporters licence.

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

Yours sincerely,

Amrik Bal
Gas Trading Arrangements