

Direct Dial: 020-7901-7074
15th January 2001

Transco, Shippers and Other
Interested Parties.

Our Ref: NET/COD/MOD/424

Dear Colleague

Modification 424 '*Payment Mechanism for Closing Top Up Adjustment Amount*'

Ofgem has considered the issues raised in modification proposal 424 '*Payment Mechanism for Closing Top Up Adjustment*' and has decided to direct Transco to implement the modification because we believe that it better facilitates the relevant objectives of Transco's Network Code.

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, in its role as Top-up Manager, uses its five LNG sites to help meet its 1-in-20 peak demand obligation. Where the sites are used to meet a national supply / demand imbalance, this is known as 'National Top-up'. At three of these sites, however, Transco will constrain shippers' LNG holdings to help alleviate what are *localised* transmission constraints. These 'Constrained LNG' (CLNG) sites are located in the south of Transco's network.

At the three CLNG sites, Transco requires shipper bookings to be at a specified level. If shipper bookings are below this so-called 'monitor level', Transco is obliged to make purchases of gas to make good the shortfall. This is called 'CLNG Top Up'.

Ofgem is of the view that as there is a multiplicity of sources of gas that could help meet national demand and supply requirements, there is any need for Transco to make National Top-up bookings. We are, however, of the view that Transco should be allowed to recover the costs, or redistribute any surplus revenues, associated with CLNG bookings.

The Top-Up Manager is required by the network code to pay shippers the Closing Top-up Adjustment Amount (CTAA). These are revenues received by the Top-up Manager from disposing of Top-up gas at the end of the storage year, which exceed the Weighted Average Cost of that Gas (WACOG). The defined mechanism by which Transco did this was inadvertently disabled by Modification 297 - Top-up Cost Treatment – which was implemented in December 1998.

Modification 297 had two effects. First, the funding obligation for Top-up was placed with Transco. Second, it modified the Top-up recovery mechanism so that Transco could only pay surplus revenues to Users on days when a Top-up Market Offer was accepted. As a consequence of this latter point, Transco has been left with no way in which it could meet its Network Code obligations to refund to Users the CTAA surplus.

Transco has indicated to Ofgem that there is approximately £140,000 relating to the Storage Year 1999/2000 that needs to be redistributed to Users.

Proposal

Transco proposes to divide the CTAA by all relevant Users' Daily Quantity Output (UDQOs) for the Top-up recovery period (December to March inclusive for the relevant storage year) to arrive at a unit cost. This unit cost will then be multiplied by each relevant User's UDQOs in the same period, as was the case prior to modification 297, to arrive at the refund due to that User.

This modification would have interaction with modification 391 "Treatment of constrained Top-up costs for 2000 to 2002". Modification 391 introduced transitional provisions by which Transco may recover costs associated with constrained top up for the storage year 2000/01 only. Under this modification Transco is required to pay shippers the revenues realised from the disposal of constrained top-up where it exceeds costs.

Modification 424 will make a distinction between constrained top-up costs and revenues, and national top-up costs and revenue. The legal text excludes constrained top-up cost from the provisional closing top-up adjustment (the weighted average cost of the top-up gas as at 30 November in the relevant storage year). Similarly, it excludes constrained top-up revenues from the determination of the out-turn closing top-up amount (the revenues received by the top-up manager following disposal of the top-up gas). The reason for this is that under Modification 391 – Treatment of Constrained Top-up Costs for 2000 to 2001- Transco is able to recover the costs associated with constrained top-up.

Respondents' views

There were six responses, all of which expressed support for a mechanism to redistribute excess revenues from the disposal of Top-up gas.

One respondent suggested that in the legal drafting the timetable for CTAA determination should be given more definition.

Transco's views:

Transco believes that in the interest of certainty and consistency it is necessary to define the mechanism by which CTAA would be paid to Users. Transco believes if the proposal were implemented CTAA would be distributed to Users via a process that is not unduly discriminatory and would better facilitate both existing Network Code provisions and the relevant objectives.

With regards to the timetable for CTAA determination, Transco state CTAA determination is based upon Transco receiving payment following the disposal of top-up gas. The top-up manager can dispose of top-up gas in various ways, one of which is via tender. The terms of the tender are determined by the top-up manager; they are not prescribed by the Network Code. Therefore, the date of transfer of top-up gas from the top-up manager to Users and the payment time in consideration of that transaction may vary from year to year.

Ofgem's views

Ofgem believes that wherever possible, costs and surpluses should be targeted at the relevant parties wherever possible. With respect to such costs and surpluses that arise from Transco's use of top-up, it is important to note that Transco's use of CLNG has a locational or geographical consideration. Thus, it could be argued that the optimum manner in which to return a surplus to Users would take into account the Users in the relevant location. Essentially, this means that costs / revenues were more accurately targeted. This is clearly preferable to a general smearing of costs / revenues.

As part of Ofgem's forthcoming Review of NTS Exit Capacity, Interruptions and LNG, consideration will be given to Transco's current use of LNG. The Review will invite

comments on the value and costs attached to Transco's current use of CLNG, with a view to making such use more efficient. A better targeting of the costs associated with the use of CLNG will be one aspect of this work.

Notwithstanding the above, however, Ofgem supports this modification, at least in the short term pending the conclusion of Ofgem's Review of Exit Capacity, Interruptions and LNG. The CTAA surplus clearly belongs with the shipping community and not Transco.

Ofgem's decision

Ofgem has therefore decided to direct Transco to implement this modification because it better facilitates the relevant objectives as stated in Standard Condition 7(1) of Transco's Public Gas Transporter's licence. In particular, we believe that the redistribution of surplus revenues to shippers better allows Transco to ensure the efficient discharge of its licence obligation.

If you have any queries in relation to the issues raised in this letter, please feel free to contact Pav Dhesi on 020 7901 7440.

Yours sincerely

Amrik Bal
Manager
Storage and Interconnectors