



Richard Robinson
Transco

By Fax

Direct Dial: 0171-932-1669

09 November 1998

Your Ref:
Our Ref :

Dear Richard,

Top-up and Urgent Modification Proposal 237 (Top-up cost treatment)

Modification 237 proposes that the burden of the costs of top-up, including booking storage for specific locations, be transferred from shippers to Transco with incentives on Transco to ensure that the amounts of top-up bookings are kept to a minimum. Where top-up is used the modification proposes that Transco should keep any revenues that may arise.

Ofgas does not believe that it was necessary to have top-up for security of supply purposes (non-locational top-up) for this storage year, though Transco would have had a continuing requirement for top-up for transportation exit constraint purposes (locational top-up). However, Transco was not able to remove top-up from the network code for the start of the 1998/99 storage year. Ofgas believes that all the costs (storage and gas) of top-up should be borne by Transco for this storage year. As top-up gas is already in storage, this year's top-up requirements should be transferred to Transco at cost. Shippers and not Transco should continue to be responsible for any profit/loss from the disposal of excess top-up gas from the previous storage year.

If top-up is used, Transco should be able to recover revenues up to and including the cost of the top-up gas and storage used. If all top-up is used Transco should be able to fully recover its top-up costs. If top-up is not used Transco should fully bear the costs of top-up. It is for consideration whether or not Transco should receive the excess revenues and bears the costs of any top-up gas disposed at the end of this storage year. To enable Ofgas to monitor the use of top-up and the revenues associated with it, following each use of top-up, Transco should prepare a report to the Director and shippers demonstrating that top-up was in fact used correctly.

Looking forward, there is an expectation that non-locational top-up is likely to be removed from the network code for the next storage year (1999/2000). However, Transco may have an ongoing requirement for locational top-up through constrained liquefied natural gas (CLNG) storage bookings in order meet its peak day exit requirements. Transco and not shippers should fully pay for constrained LNG from the 1999/2000 storage year. Transco should not be able to receive any revenues for the use of locational top-up.

Under modification proposal 237 there would be the possibility of Transco receiving revenues well in excess of the original top-up costs if some or all of top-up is used this winter. We are concerned that it may not be appropriate for Transco to keep all of these revenues. Ofgas does not accept that the change to the network code described in modification proposal 237 should be made.

Appendix A further explains Ofgas views on top-up for this storage year and for storage years thereafter.

Please copy this letter to shippers and other interested parties with notification of the non-implementation of modification 237. If you have any questions about this letter or its attachment do not hesitate to contact me.

Yours sincerely



Tahir Majid
Manager, Gas Balancing

c.c. Richard Gray – Transco

Appendix A

1. Top-up Cost Treatment

1.1 Present Position

Top-up is gas placed in storage by Transco and is intended to enhance security of supply during severe weather conditions (non-locational top-up) and to avoid exit transportation constraints on Transco's pipeline (locational top-up). For security of supply purposes top-up is booked to ensure there is sufficient gas to meet a peak day in 20 years (1-in-20 peak day) and the coldest winter in 50 years (1-in-50 severe winter) to the extent that shippers have not provided for this themselves. For exit purposes, where there is insufficient pipeline capacity to meet the 1-in-20 peak day capacity, Transco books local storage in liquefied natural gas facilities that it determines are constrained (CLNG) instead of reinforcing pipeline.

Top-up gas is bid onto the flexibility mechanism at a price based on the cost of gas and storage and a multiplicative factor of N. Currently N equals 20. Top-up is intended to be priced such that shippers are encouraged to make sufficient provision for peak demand. Transco recovers the cost of top-up from shippers through a revenue neutrality mechanism. All shippers are charged a percentage of the overall costs of providing top-up according to the demand of their firm customers in the winter months. Transco does not pay for top-up, even where it is used in place of system reinforcement that would otherwise have been made at Transco's expense. Transco interprets its PGT licence obligations, for the provision of reasonable economic incentives for relevant suppliers to secure that the domestic supply security are satisfied, through the provision of top-up and the multiplicative factor N.

Top-up Requirements for 1998-9

	Full Rough	Partial Rough
Space (GWh)	0	323
Deliverability (GWh/d)	0	61
Avonmouth CLNG (GWh)	229	229

Storage Bookings for 1998-9

	Full Rough	Partial Rough
Avonmouth		
Space (GWh)	228.8	228.8
Deliverability	45.77	45.77
Grain		
Space (GWh)	0.0	77.7
Deliverability	0.0	15.52
Cost (£millions)	3.17	4.03

Implementation of modification proposal 238, Revised methodology for top-up calculation, would result in "Full Rough" availability and hence a lower cost and requirement for top-up. Ofgas is still considering the final modification report for proposal 238.

1.2 Issues

Though non-locational top-up could be seen as a means of ensuring that domestic shippers meet their domestic security standards {PGT licence Condition (1) (d) and Suppliers licence Condition (9)}, non-locational top-up includes an assessment of the requirements of firm industrial and commercial demand. Furthermore, this firm demand assessment takes no account of commercial interruption. The calculation of top-up is flawed and inevitably leads to an overestimation of top-up requirements. Another area of concern is that both Transco and BG Storage are part of BG plc thus any overestimation of top-up will benefit BG plc.

The value of N distorts prices on the flexibility mechanism though this has been mitigated to some extent by the reduction in the value of N from 50 to 20 from this storage year. However, it seems to be wholly inappropriate that N should apply to gas required for constrained exit purposes. Furthermore, the presence of top-up distorts storage bookings.

There has been an increase in the availability and diversity of peak gas on the Transco pipeline system. There is not a need for top-up in the long term. However, Transco has not until recently taken steps to remove top-up from the network code or addressed top-up in respect of its safety case. Ofgas understands that Transco intends to remove the requirement for non-locational top-up for storage year 1999/2000.

In our Conclusions document, Review of top-up gas, published in April 1998¹, we stated that it was our initial view that the costs of non-locational top-up should not continue to be borne by shippers. Furthermore, Ofgas was firmly of the view that Transco should bear the costs of locational top-up.

2. Modification 237, Top-up Cost Treatment

2.1 Proposal

Mod 237 proposes that the burden of the cost of top-up, locational and non-locational, be transferred from shippers to Transco with incentives on Transco to ensure that the amounts of top-up bookings are kept to a minimum. However, where top-up is used the modification proposes that Transco keeps any revenues that may arise.

¹ This followed a consultation document, Review of top-up gas, February 1998.

2.2 *Transco Response*

Transco is opposed to taking over responsibility for top-up costs. Although the proposal would reduce the cost to shippers, Transco is concerned that it would also remove the financial incentive for gas shippers to meet their domestic security standards.

2.3 *Shipper's response*

Shippers supported the transfer of the costs of top-up to Transco. There were varying views on the appropriate cost at which top-up gas in store should be transferred to Transco. Shippers were also concerned about the potential ongoing requirement for constrained LNG.

2.4 *Ofgas' Decision*

There is not likely to be any reduction in the incentives for shippers to meet their domestic security standards if the costs of top-up are moved to Transco. Potential exposure to high flexibility prices for failing to provide for the needs of domestic customers should be sufficient incentive for shippers.

Moving the costs of top-up to Transco should further incentivise Transco to remove non-locational top-up from the network code for the 1999/2000 storage year. Locational top-up is used by Transco in place of system reinforcement to meet Transco's PGT licence 1-in-20 peak day exit obligations. It is inappropriate that shippers should pay for Transco's licence obligations through energy balancing neutrality charges.

Ofgas agrees with shippers that Transco should meet the costs of gas and storage for top-up. Under modification proposal 237 there would be the possibility of Transco receiving revenues well in excess of the original top-up costs if some or all of top-up is used this winter. We are concerned that it may not be appropriate for Transco to keep all of these revenues. Ofgas does not accept that the change to the network code described in modification proposal 237 should be made.

3. **Way Forward**

3.1 **Storage year 1998/99 (this storage year)**

Ofgas does not believe that it was necessary to have non-locational top-up for this storage year. However, Transco was not able to remove top-up from the network code for the start of the 1998/99 storage year. In consideration of this, Ofgas believes that all the costs (storage and gas) of locational and non-locational top-up should be borne by Transco for this storage year. As top-up gas is already in storage, this year's top-up requirements should be transferred to Transco at cost. Shippers and not Transco should continue to be responsible for any profit/loss from the disposal of excess top-up gas from the previous storage year.

If top-up is used, Transco should be able to recover revenues up to and including the cost of the top-up gas and storage used. If all top-up is used Transco should be able to fully recover its top-up costs. If top-up is not used Transco should fully bear the costs of top-up. It is for consideration whether or not Transco should receive the excess revenues and bears the costs of any top-up gas disposed at the end of this storage year. To enable Ofgas to monitor the use of top-up and the revenues associated with it, following each use of top-up, Transco should prepare a report to the Director and shippers demonstrating that top-up was in fact used correctly.

3.2 Storage year 1999/2000 Onwards

It is our view that Transco should take steps to ensure that non-locational top-up is eliminated for the storage year 1999/2000. However, Transco may continue to have a longer term need for locational top-up in place of system reinforcement. Locational top-up should operate in a similar manner to operating margins. In particular, the value of N should not apply and top-up should not be bid onto the flexibility mechanism. Rather, where there would otherwise be a transportation exit constraint top-up should be used and perhaps priced at the prevailing System Marginal Buy Price. Transco and not shippers should fully pay for top-up. Transco should not be able to recover the costs of or receive any revenues from the use of top-up.

It is for consideration whether the present arrangements for locational top-up should continue in their current form. Currently, Transco can determine whether or not a BG Storage facility is constrained. It is currently envisaged that Transco will be able to individually negotiate with future storage operators as to whether non-BG Storage facilities will be constrained.

If there were future exit capacity shortfalls, locational top-up storage requirements could be sourced by Transco on the same basis as other shippers in an auction. Alternatively, Transco could offer financial incentives to shippers for the constraining of part or all of shipper's storage bookings. Earlier this year Transco presented a paper to the network code Planning and Security workstream on the range of alternatives to the current CLNG arrangements.

There need not be the current automatic requirement for all shipper storage bookings being constrained in particular storage facilities. Ofgas intends to commence a review of LNG storage facilities in May 1999 and this review may include the consideration of these CLNG issues.



Urgent Modification Proposal 237

Top-up cost treatment Decision

25 November 1998

Present Position

Top-up is gas placed in storage by Transco and is intended to enhance security of supply during severe weather conditions (non-locational top-up) and to avoid entry transportation constraints on Transco's pipeline (locational top-up).

Top-up gas is bid into the flexibility mechanism at a price based on the cost of gas and storage and a multiplicative factor of 'N'. Currently 'N' is equal to 20. Top-up is intended to be priced such that shippers are encouraged to make sufficient provision for peak demand. Transco recovers the cost of top-up from shippers through a revenue neutrality mechanism. All shippers are charged a percentage of the overall costs of providing top-up according to the demand of their firm customers in the winter months. Transco does not pay for top-up, even where it is used in place of system reinforcement that would otherwise have been used at Transco's expense.

Proposal

It has been proposed that the burden of the cost of top-up, locational and non-locational, be transferred from shippers to Transco with incentives on Transco to ensure that the amount of top-up bookings are kept to a minimum. However, where top-up is used, the modification proposes that Transco keeps any revenues that may arise.

Possible Impact on Customers

Any change in shipper costs may ultimately be passed onto customers.

Ofgas' Decision

Ofgas believes that all the costs (storage and gas) of top-up should be borne by Transco for this storage year. As top-up is already in storage, this year's top-up requirements should be transferred to Transco at cost. Shippers and not Transco should continue to be responsible for any profit/loss from the disposal of excess top-up gas from the previous storage year.

Under Modification 0237, there would be the possibility of Transco receiving revenues well in excess of the original top-up costs if some or all top-up is used this winter. We are concerned that it may not be appropriate for Transco to keep all of these revenues. Therefore, Ofgas does not accept that the change to the network code described in modification 0237 should be made.

Further Information

The Transco contact is Richard Robinson on 0121 623 2285
The Ofgas contact is Tahir Majid on 0171 932 1669