

Modification Report
URGENT Modification Reference Number 237

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.12.4.

1. Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.2(a) Ofgas has agreed that this Modification Proposal should be treated as Urgent because implementation should take place before the relevant shipper invoices are issued.

2. Procedures Followed:

Transco agreed with Ofgas (and has followed) the following procedures for this Proposal;

Proposal circulated to interested parties: 30th June 1998

Consultation responses to Transco: 5.00pm Tuesday, 14 July 1998

Final modification report to Ofgas: 31st July 1998

3. The Modification Proposal:

Various changes to the existing Top-Up regime and rules are now both appropriate and necessary, in the light of -

- the abolition of the V-factor
- this year's changes to the Rough storage regime
- issues raised in Ofgas' recent consultation paper on Top-Up
- experiences in 1997/8

Transco have developed a Modification (238) to address necessary changes to the existing rules on calculating Top-Up, to ensure these reflect the new storage regime.

This modification has been raised by BGT to address the issue of how Top-Up is funded.

Ofgas' recent paper (April 1998) presenting their conclusions from their Review of Top-Up issues says -

".....we believe that there would be merit in examining whether all the costs of Top-Up should continue to be borne by shippers. Should the cost recovery of Top-Up be moved from the shippers to Transco, this would incentivise Transco to take steps to ensure that the amounts of Top-Up bookings were kept to a minimum.....it is our initial view that these costs should not continue to be borne by shippers."

That paper also refers to -

".....The current anomaly that shippers pay for locational Top-Up rather than Transco"

and says -

"A likely conclusion of our energy balancing review is that Transco should bear the costs associated in their entirety with transportation constraints..... to the extent that Transco has to book storage in particular locations, Ofgas is firmly of the view that Transco should bear the costs of such bookings."

The Network Code provides the rules by which Transco recover from shippers the costs of Top-Up: in essence this Modification proposes the deletion of this process.

Charging options

It is proposed that Transco bear all the Top-Up costs, both as a matter of principle as being an appropriate change and also as being a relatively simple change to implement.

Specific Changes

BGT's proposal is that the change can best be achieved by the deletion of the rules in Sections P6.4 and P6.6 of the Code which relate to recovery of net Top-Up costs from Users (and to distribution of net revenue to Users) and settlement of the Out-turn Closing Top-Up Amount (which can be a surplus or a deficit).

This would have the effect of leaving Transco with any residual income as well as residual costs.

BGT recommends that the rules relating to the calculation and publication of Top-Up costs should be retained, because (in BGT's view at least) Top-Up has to be assumed an integral part of the Network Code until a revised Transco Safety Case covering a regime without Top-Up has been prepared and adopted. Hence it is important to retain the rules relating to the determination of Top-Up, and discussion on the future of Top-Up would be aided if existing rules relating to publication are retained.

Associated Issues

Further issues were raised in the Planning & Security Workstream discussion, namely the ownership of the 228.8 GWh of gas in Avonmouth needed for 1998/9 Top-Up, the limitations (if any) on Transco disposing during a winter of gas which became surplus to requirements for the remainder of the winter, and treatment of the ensuing revenue.

The Avonmouth gas is effectively "owned" by shippers. The options include -

- the gas could continue to belong to shippers, with Transco managing the volume and shippers bearing gas-related costs and receiving gas-related income, but with Transco bearing non-gas-related (ie. storage) costs
- the gas could be sold, with shippers receiving the proceeds, leaving Transco to secure gas for Top-Up purposes as it chooses
- the gas could be transferred to Transco, at an appropriate cost, for them to own and use subject to limitations on use, disposal and future purchases consistent with existing rules and practice relating to Top-Up gas.

The first of these is complex and implies continuing intrusion and involvement by shippers in Top-Up management and ongoing activity, which is at least inconsistent with the view that Transco should be accountable for Top-Up and its costs. This option is not recommended.

The difficulty with the second option is that if 228.8 GWh (7.8 mill thms) of gas in Avonmouth were offered for sale there will be little demand from the shipping community and the principal prospective purchaser will be Transco. So if an auction were held offering the gas in store or at the NBP the likely outcome would be bids from shippers at "spot less the Avonmouth withdrawal charge" (ie spot minus 0.6 p/thm, say about 8.3 p/thm), and Transco could expect to capture the gas at about 9 p/thm, giving compared with WACoG a net loss of 6-7 p/thm to be absorbed by shippers.

Hence it is recommended that 228.6 GWh of Top-Up gas in Avonmouth be transferred to Transco at a defined price, and that Transco then be free to use and dispose of this gas subject to consistency with existing rules and practice relating to Top-Up gas (eg. disposals/purchases will be by price tender, with options of transfer either at the NBP or in store)

BGT further recommends that the transfer price be based on the lower of:

- the WACoG of Top-Up gas as at 1 June 1998
- the lowest IPE monthly settlement price at 30 June 1998 for the months of July, August or September 1998 (likely to be a little below about 9 p/thm) plus the price of injection into Avonmouth (5.6 p/thm),
- and less a discount of 5%.

The loss on the transfer should be borne by shippers as a "closing margins smear".

4. **Transco's opinion:**

Transco believe that to make Transco responsible for Top-Up costs removes one of the fundamental principles underlying the competitive gas market. The Transco PGT Licence clearly states that one of the relevant objectives of the Network Code is to provide a reasonable economic incentive for gas suppliers to secure that the domestic supply security standards are met. Removal of the annual costs of Top-Up, removes any link between shippers, and hence suppliers, peak gas provisions and any consequence of under-provision of gas to meet the domestic security standard.

Furthermore, the current special condition 9C does permit Transco to provide Top-Up on a neutral cost basis.

Under the current Top-Up rules Transco are constrained to strict operating and purchasing arrangements as specified in the Network Code and agreed with the shipping community and Ofgas. If Transco become responsible for the Top-Up costs they will not expect to be constrained by the current Network Code rules and could become more active in the peak gas trading market which may distort the market and have a significant influence on prices for peak gas.

5. **Extent to which the proposed modification would better facilitate the relevant objectives:**

This modification goes against the relevant objectives as it removes a substantial part of one of the primary elements of those objectives, the requirements under condition 7 (1)(d) for Transco to provide an appropriate incentive to domestic shippers to meet their domestic security standards. The cost of the Top-Up service is a major factor in providing that incentive. If the domestic suppliers do not call for an appropriate level of peak gas service then shippers will not be purchasing them and hence the cost of Top-Up would be higher. If Transco bear the cost of Top-Up then the incentive for suppliers to meet their domestic security standards is substantially diluted.

Clearly if this modification is approved then the PGT Licence condition must be reviewed to establish if it is still appropriate.

6. **The implications for Transco of implementing the Modification Proposal, including:**

a) **implications for the operation of the System and any BG Storage Facility:**
There are no implications.

b) **development and capital cost and operating cost implications:**
This proposal will increase Transco's operating costs and those costs are not provided for in the current formula.

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:**
As stated in 5 above Transco maintain that it is appropriate for the Top-Up costs to be recovered from shippers otherwise the incentive for suppliers to meet their domestic security standards will be greatly reduced.

d) **analysis of the consequences (if any) this proposal would have on price regulation:**
There is no impact.

7. **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:**

None

8. **The development implications and other implications for computer systems of Transco and related computer systems of Relevant Shippers:**

None

9. **The implications of implementing the Modification Proposal for Relevant Shippers:**

Shippers with firm gas customers will see a reduction in their Balancing Neutrality costs.

10. **The implications of implementing the Modification Proposal for terminal operators, suppliers, producers and, any Non-Network Code Party:**

Suppliers will no longer have sufficient incentives in place to meet their domestic security standards.

11. **Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each Relevant Shipper and Non-Network Code Party of implementing the Modification Proposal:**

As stated in section 5 part of the relevant objectives are not being met if this proposal goes ahead with regard to appropriate incentives for gas suppliers.

12. **Analysis of any advantages or disadvantages of the implementation of the Modification Proposal:**

Advantages: This proposal reduces the cost of Balancing Neutrality to shippers.

Disadvantages: This proposal removes a major element of the financial incentive for gas suppliers to meet their domestic security standards.

Under the current Top-Up rules Transco are constrained to strict operating and purchasing arrangements as specified in the Network Code and agreed with the shipping community and Ofgas. If Transco become responsible for the Top-Up costs they will not expect to be constrained by the current Network Code rules and could become more active in the peak gas trading market which may have a significant influence on the market and prices for peak gas.

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

Transco have received eight responses, seven of which support the fact that Transco should bear the cost of Top-Up and one (Shell Gas Direct) who believe that constrained Top-Up costs should be the responsibility of Transco and because the separation of this from the rest of Top-Up would require significant drafting it would be easier if all Top-Up costs were the responsibility of Transco.

With regard to the treatment of Top-Up revenues, BGT believe that any income should be part of regulated income, Yorkshire Energy and BP Gas that shippers receive the income. Other respondents made no comment.

With regard to the transfer of gas to Avonmouth for constrained purposes, United Gas Services and National Power supported the principle of a defined price as proposed by BGT, but BP Gas, Yorkshire Energy and Southern Electric did not favouring various alternatives. These included option 1 (YE), no transfer should occur as it is not needed (BP) and Transco should decide itself if it is bearing the cost (SE).

Scottish Hydro requested that this mod be considered alongside mod 233.

Transco Response:

Transco are opposed to being responsible for Top-Up costs (see section 4 - Transco's opinion).

If Transco are responsible for the costs then all revenues should be treated as excluded from "Transportation Revenue" as currently defined in the Transco PGT Licence, special condition 9C. This excludes from "Transportation Revenue" any revenues incurred that relates to the acquisition or disposal of gas for the efficient operation of the system or recovery of costs incurred as the Top-Up Manager.

Transco agree with Southern Electric that if the costs are borne by Transco then it would be Transco's decision how it acquired the gas for Avonmouth.

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

The modification has no impact on this.

15. **The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:**

None

16. **Programme of works required as a consequence of implementing the Modification Proposal:**
None
17. **Proposed implementation timetable (inc timetable for any necessary information systems changes):**
Not applicable.
18. **Recommendation concerning implementation of the Modification Proposal:**
Transco recommend that this modification is not approved.
19. **Restrictive Trade Practices Act:**
Not applicable.

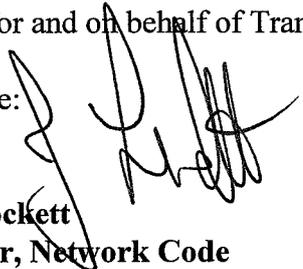
20. Transco's Proposal:

This Modification Report contains Transco's proposal not to modify the Network Code and Transco now seeks direction from the Director General in accordance with this report.

21. Text provided pursuant to Rule 9:

Signed for and on behalf of Transco.

Signature:



John Lockett
Manager, Network Code

Date:

31. 7. 98

Director General of Gas Supply Response:

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **237**, version **1.0** dated **(31/7/98)**) should not be made as a modification to the Network Code.

Signed for and on behalf of the Director General of Gas Supply.

Signature:

Kyran Hanks
Director of Transportation Regulation

Date: