

Modification Report
Enhancements to Winter Injection Process
Modification Reference Number 0671
Version 2.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

The original Proposal was as follows:

"It is proposed that the calculation of Top-up Market Offer Price (TMOP) be amended to ensure that it is based upon prices available prior to the Day and that this price reflects the cost of firm Storage Capacity.

For the Storage Capacity unit rate element (C/T) it is proposed that:

- If the Top-up Manager had made one or more firm Storage Capacity bookings prior to the Winter Period at that Storage Facility, further acquisition of Storage Capacity for Winter Injection would not reduce the unit rate element to a lower value than that represented by these firm bookings.
- If the Top-up Manager had not made a booking prior to the Winter Period at that Storage Facility, the Storage Capacity unit rate element would be set to the weighted average price of firm Storage Capacity sold by Transco LNG Storage to Users in respect of that Storage Year.

For the System Entry Overrun Charge element (E) within the Top-up Market Offer Price it is proposed that this be set each month to the value of the System Entry Overrun Charges applying to the relevant System Entry Point at 13.00 on the last Day of the previous month .

Transco has discussed various price alternatives for both the E and C/T terms within the NT&T Workstream and would welcome any alternative suggestions within the representations.

In addition, it is proposed that the Top-up Manager be permitted to take account of all relevant information Transco has available in respect of the Day in determining the quantity to be nominated as a Winter Injection. It is also proposed that the Top-up Manager be permitted the full range of nomination timing flexibility permitted to Users under the Network Code.

Finally, to ensure that gas procured by the Top-up Manager is disposed efficiently when the gas-in-storage exceeds monitor levels, it is proposed that the present restriction which only allows the Top-up Manager to review such surpluses at the end of each month, be removed to allow a daily review and adjustment of stocks."

This Proposal was discussed by the NT&T Workstream. The main discussion centred on the existing principles behind consistently setting the TMOP at an appropriate level to incentivise Shippers. These were as follows:

- For Users that had a negative energy imbalance on the Day when a Top-up Market Offer were accepted, TMOP would probably set the SMP_{buy} at which they would be cashed-out.
- Users who had made use of adequate security of supply provisions to prevent a negative imbalance, would be able to avoid being cashed-out at SMP_{buy} and might even have the opportunity of trading any surplus energy at a price slightly below the TMOP.
- The mitigation available to Users who had made inadequate security of supply arrangements and were consequently facing the prospect of a negative imbalance, would be from trades which, as outlined above, might be set at prices only slightly below TMOP.

The Workstream accepted that a high TMOP should continue to apply even if storage capacity were only acquired by the Top-up Manager on an interruptible basis. Implementation of this Modification Proposal would establish this principle.

Whilst the magnitude of TMOP was considered as the more important aspect of this Proposal, the Workstream did accept that a minor amendment to the original Proposal in respect of the System Entry Overrun Charge element was desirable. Rather than base this on the previous month, it was accepted that this element could be based on the average of the previous Winter Period.

2. Transco's Opinion

Whilst acknowledging Ofgem's suggestion of a review of the role that Top-up plays within the wider context of security of supply in its recent decision letter for Modification Proposals 0659 and 0660, Transco believes it is important to ensure that the principles behind the establishment of Top-up are consistently applied for the current Top-up mechanism. Transco also believes that where sensible enhancements to the present regime are identified for which implementation would be consistent with furtherance of the relevant objectives, these enhancements should be raised as Network Code Modification Proposals.

Transco bases this assessment on the belief that a more fundamental review of the role of Top-up could not be completed before the end of the present Winter Period and any changes arising from such review may not be able to be implemented for next winter. A policy of enhancement of the present regime continues the approach adopted in the implemented Modification Proposal 0504 which was pursued in parallel with another Modification Proposal (0472) that concentrated on the more fundamental principle of Top-up cost allocation.

This Modification Proposal addresses the consistency issue in respect of TMOP by advocating more stability in the term designed to reflect firm storage capacity unit prices. Transco suggests that basing this parameter on LNG auction outcomes in cases where the Top-up Manager has not procured Storage Capacity ahead of the winter, achieves the principle objective of producing a TMOP set at an appropriate incentive level. Whilst other more sophisticated formulations equivalent to Storage Capacity unit rates might be derived, Transco considers

that implementation of this Proposal in its present form would yield a straightforward and transparent method for calculating TMOP.

Transco is of the view that in making decisions on both injection of Top-up gas and its subsequent disposal, the Top-up Manager should have the flexibility both to take into account the best information available and to take action on that basis. In terms of Winter Injection, whilst it is now acknowledged that the Top-up Manager has a certain flexibility in the information it uses, it nevertheless has to make its decision by 13.00 D-1. In the subsequent hours further information would become available as a result of the ongoing nomination process. For this reason Transco believes that setting a time of 18.00 D-1 might reduce the range of subsequent within day nomination changes and is therefore more appropriate.

In respect of disposal of Top-up gas, Transco believes that the present restrictions which only allow the Top-up Manager to reassess the potential for disposal at the end of each month do not serve any useful purpose. In fact a requirement of awaiting the end of month prevents the Top-up Manager from making efficient decisions. Transco believes that the Top-up Manager should be able to arrange disposal at whatever date it becomes clear that the Top-up stocks exceed the level required to maintain security of supply.

3. Extent to which the proposed modification would better facilitate the relevant objectives

The proposed additional flexibility in making decisions on winter injection and subsequent disposal of Top-up gas is consistent with economic and efficient operation by the licensee of its pipe-line system. Improving the consistency of TMOP in cases where the Top-up Manager has or has not bought Storage Capacity ahead of the winter is consistent with the provision of economic incentives for relevant suppliers to meet the gas security standards.

4. The implications for Transco of implementing the Modification Proposal , including

a) implications for the operation of the System:

Implementation would lead to greater within-day stability in winter injection nominations which might in turn have a beneficial effect on the stability of the within-day gas market. Ensuring that TMOP would be set at a more consistent incentive level would ensure that its effects on OCM prices on high demand Days would be independent of whether Top-up gas was injected prior to the Winter Period or within the Winter Period.

b) development and capital cost and operating cost implications:

Transco has not identified any development or capital cost implications. By improving the flexibility of its injection and disposal it is expected that implementation would reduce the Top-up Manager's operating costs.

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 is not making any proposal for recovery of any additional costs arising from the implementation of this Modification Proposal.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Transco is unaware of any such consequence.

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

By increasing the flexibility of Top-up injections and disposal, implementation of this Proposal might be expected to reduce Transco's level of contractual risk.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

Transco is unaware of any such implications as its present systems have the flexibility to incorporate TMOP price changes resulting from implementation of this Modification Proposal.

7. The implications of implementing the Modification Proposal for Users

Transco believes that Users would be more consistently incentivised to make supply provision so benefiting security of supply. Users would also benefit from the avoiding the risk of instability in the OCM that might exist where the Top-up Manager is constrained on the information it can use in making winter injection nomination decisions.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

Implementation would help ensure greater within-day consistency in winter injection nominations and this would assist the relevant Storage Operator in maintaining efficient operation of its plant.

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 unaware of any such consequence.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- More consistent incentives on Users in respect of maintaining security of supply.
- Greater stability in winter injection nominations with potential benefits for within-day gas market price stability.
- Greater potential for more economic disposal of surplus Top-up gas.

Disadvantages

- Transco is unaware of any disadvantages.

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

Seven representations were received in respect of the Proposal:

Respondent	Response
British Gas (BGT)	Support
Centrica Storage Ltd (CSL)	Support
Edf Energy Plc (Edf)	Qualified Support
Powergen (PG)	Not in support
RWE Innogy (Inn)	Partial support
SSE Energy Supply Ltd (SSE)	Not in support
Total Gas & Power Limited (Total)	Not in support

The following comments were made:

General

Total did not provide any comment on individual elements of the Proposal believing that “Whilst some aspects of the proposal are sensible we continue to believe that removing Top-up obligations from NGT and allowing market forces to apply in this area will sharpen relevant market levels of security commensurate with the best available market information.”

PG, whilst acknowledging “that the proposed modification has some merits in respect of managing disposal of Top-up gas and improving the information available to Transco to enable them to manage winter-injection”, did “not feel that the proposal should be implemented at this stage.”

CSL commented specifically on the issue of TMOP and confirmed its support for the remainder of the Proposal as presented.

Inn commented on all aspects of the Proposal and concluded that it did not "believe Transco have justified these proposals or demonstrated they would be significantly more efficient. We still have significant concerns regarding Top-Up arrangements generally and fully support Ofgem's suggestion that there should be a review at the end of this winter. Until this review is complete we do not believe that there should be any further changes to arrangements". Total and PG also expressed support for the proposed 2004 Top-up Review.

Transco Response

Transco supports the suggestion of a Top-up Review but believes, in the interim, attention should be given to the present anomalies within the process, particularly

in respect of winter injections. Transco does not believe that resolution of such anomalies would adversely influence the outcome of any review.

Top-up Market Offer Price (TMOP)

BGT supported this aspect of the Proposal and confirmed their understanding that “the primary aim of this modification is to address an unforeseen consequence of the current formula for determining the price at which Top-up gas is offered to the market...” and agreed “that it is an important principle that Top-up gas is only offered to the market at a significant differential to the market price”. BGT also supported the proposed change to the timing of the determination of the System Entry Overrun Charge element within the TMOP calculation “as it will simplify the determination of that particular element of the TMOP formula.”

CSL confirmed its support for “the proposed change in relation to the C/T element as an urgently-needed modification to the TMOP formula.”

Inn supported “Transco’s pragmatic proposals to the change the E & C element of the formula, and would expect that in the event this modification proposal is accepted, Transco will immediately release the values of these formula elements to shippers.”

Edf commented that “we believe that it is essential to be able to calculate the Top-up Market Offer Price (TMOP) for all gas used during the winter period” and noted that the Proposal now included for the System Entry Overrun Charge to be based on the average of the previous winter period.

SSE expressed concern that by using the previous Storage Year as a basis for establishing the System Entry Overrun Charge “the use of prices from a period so far out could distort prices and participants’ activities..... As such we suggest the calculation should remain as it is or be based on costs incurred closer to the event.” Additionally, in respect of applying a firm storage capacity rate it expressed concern that “this would not be cost reflective and would not be any more efficient. In particular we are unclear why costs should be based only on Transco LNG storage.”

Transco Opinion

Transco welcomes the support for changes to the TMOP calculations. Most of the price elements would be within the public domain, including the average firm LNG capacity rate, which, after applying the multiplier, Transco believes would be the dominant element within the TMOP calculation. Transco would also point out that if the demand forecast indicated more than 85% of peak day demand the relevant prices would be entered on the OCM. Transco also believes that use of a Transco LNG Storage price would provide the appropriate incentives as well as being transparent.

The System Entry Overrun Charge element would be a very small cost component within the TMOP that is not expected to move materially year on year. Consequently, Transco believes that basing this element on the previous winter would distort neither the TMOP nor participant activities, but represents an expedient solution. In any event, since the value of the System Entry Overrun Charge is not confirmed until after the Day, the original Proposal required amendment in order that a Top-up Market Offer could be correctly posted in time

to take effect on the first Day of a month if required. In response to the cost reflectivity concern raised, Transco believes that while the TMOP should be as cost reflective as possible, the primary requirement should simply be to generate a very high price. The multiplier applied to the average LNG auction price would achieve this.

Winter Injection Nomination

Edf supported "the amendments to allow the Top-up Manager to take account of all relevant information. However, we believe that any information the Top-up Manager receives to make a decision regarding Top-up Manager actions should be published to the market as soon as possible, within 60 minutes if possible".

BGT expressed reservations with regard to how information is treated by the Top-up Manager believing that "the Top-up managers decision making process with regard to winter injection needs to be as transparent as possible. It should be clearly understood what information sources that Transco can use to determine its winter injection requirements." Additionally, BGT felt "that it should also be understood how the Top-up manager will treat additional information" and strongly felt that "it is important that information provided to the Top-up Manager for security of supply purposes should not be further disseminated within Transco nor confer any unfair commercial advantage on Transco's wider operations."

Inn stated that "Whilst it is appropriate and efficient for Transco to use the most up to date information available it is also essential that this information is credible and reasonably accurate" and felt that the industry should be able to understand what information is being used and that there would exist a reasonable level of transparency. In respect of this element of the Proposal, and that concerning the timing of disposal of gas-in-store, Inn summarised "Unless Transco can provide more supporting evidence as how these two elements of the Proposal will enhance Top-up efficiency, and in the absence of any post event scrutiny of Transco's actions, we would not support implementation of these aspects of the proposal at the current time." Inn finally commented that "We would not however, want this qualification of support to hinder implementation of changes to the Top-up Market Offer price."

Transco Opinion

Transco would refer to the legal text and assure Users that the primary change would be to the nomination time. The additional information used by Transco would be the Storage Facility Nominations and the Demand Forecast. The commercially confidential nature of such information would prevent Transco from making it available to the market. It is important to appreciate that Transco will not be in receipt of additional information compared to what it received at present, simply that it wishes to be able to take more information into account in determining the Winter Top-up Injection Requirement than it is presently able to.

Top-up Gas Disposal Flexibility

BGT, CSL and Edf were supportive of removing the present Network Code restriction on the Top-up Manager to dispose of surplus gas-in-store at the end of the month to that which would allow a daily review and efficient adjustment of stocks.

SSE believed it is "essential that actions are the most economical and efficient " and therefore it is "appropriate to allow the Top-up Manager to review monitor levels on a daily basis.." However, it also believed that "it may be appropriate for Transco to take a longer term view, say over the entire winter period."

Inn were less convinced of this proposed change, citing the lack of experience of winter injection nominations to date. Whilst the present restriction "may mean Transco to lose the opportunity of disposing of this gas at prices close to the price paid to purchase it it might also lead to some winter injection nominations which might otherwise have been made, not being made".

Transco Opinion

Transco would consider the magnitude of its Top-up surplus, the likelihood of further monitor breaches and prompt and forward gas prices before taking disposal action. This would both promote efficient operation and allow for a longer term view over the winter.

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

Transco is unaware of any such requirement.

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

Transco is unaware of any such requirement.

14. Programme of works required as a consequence of implementing the Modification Proposal

Transco is unaware of any such requirement.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

Transco would recommend implementation immediately following direction.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends this Proposal be implemented.

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

Amend paragraph 2.8.5(a) to read as follows:-

- “(a) determine on each Day from November to April in any Storage Year.....for that Storage Year;”

Amend paragraph 3.4.1 to read as follows:-

- “3.4.1 Subject to paragraphs 3.4.6 and 3.4.7, the Top-up Manager will, as soon as possible after 18.00 hours on the Preceding Day determine in respect of each Day.....”

Amend paragraph 5.3 to read as follows:-

“The Market Offer Price.....whichever is the lesser:-

$$TMOP = W + G + E + N \times (C/T)$$

where

W is the unit rate.....Gas Flow Day;

E is the average of the unit rate (in pence/kWh) of the System Entry Overrun Charge determined in accordance with Section B2.12.3 for the relevant Storage Connection Point for each Day in the period 1 November to 30 April in the previous Storage Year;

G is the Top-up WACOG;

N is 20;

C is:-

- (i) where the Top-up Manager has purchased Storage Capacity prior to the start of the Winter Period at that Storage Facility, the greater of:-

(1) the average cost (in pence/kWh) of each unit of Storage Capacity which the Top-up Manager has purchased prior to the start of the Winter Period at that Storage Facility, multiplied by the total quantity of Storage Space held by the Top-up Manager at the date of the Top-up Market Offer in respect of the Storage Year for the facility;

(2) the total cost (in pence) to the Top-up Manager at the date of the Top-up Market Offer for all Storage Capacity purchased by it in respect of the Storage Year for the facility;

- (ii) where the Top-up Manager has not purchased Storage Capacity prior to the start of the Winter Period at that Storage Facility, the average cost (in pence/kWh) of each unit of Storage Capacity sold by Transco LNG Storage in aggregate in respect of the Transco LNG Storage Facilities prior to the start of the Winter Period, multiplied by the total quantity of Storage Space held by the Top-up Manager at the date of the Top-up Market Offer in respect of the Storage Year for the Storage Facility in question; and

T is the total quantity (in kWh) of Storage Space held by the Top-up Manager.....Storage Year for the facility

For the purposes of the Storage Year.”

Amend paragraph 6.4.1 to read as follows:-

“6.4.1 Where following the acceptance of that price determined by reference to the formula in paragraph 5.3 (for which such purposes N shall be deemed to be one, and C shall be deemed to be the total cost (in pence) to the Top-up Manager at the date of the Top-up Market Offer for all Storage Capacity purchased by it in respect of the Storage Year for the facility) any such excess this paragraph 6.4.”

Signed for and on behalf of Transco.

Signature:

Mike Calviou
Commercial Frameworks Manager
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 **0671**, version **2.0** dated **13/01/2004**) 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 **2.0**.

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.