

TRANSCO WORKSTREAM REPORT

"Application of SO Commodity Charges to all NTS Loads"

Version 3.0

1. Background to The Modification Proposal

Modification Proposal 0532 was raised following the decision of Ofgem not to veto Transco's Pricing Consultation Proposal 70 (PC70). The stated objectives of PC70 were as follows:

- That the NTS standard commodity charge be replaced by a SO commodity charge;
- That the SO commodity charge be based upon target SO revenue (whereas the NTS standard commodity charge was based on 35% of target NTS revenue); and
- That the SO commodity charge should apply to all gas transported through the NTS, irrespective of the type of end load. A particular change is that the charge would be payable on all gas transported to storage sites.

In its proposal, Transco also welcomed views on whether it was appropriate to continue with the optional commodity charge in its present form, whether it should now be reconstituted in a different form or removed altogether, and whether the SO commodity charge should be distance-related rather than a standard charge.

Whilst there was a range of views expressed on the proposal and some comments on the distance-related issue, Ofgem decided not to veto the proposal and expressed its own views in an accompanying paper. Transco's consultation report and Ofgem's views are available on Transco's web site (www.transco.uk.com).

One view expressed by Ofgem was on the aspect of splitting the SO Commodity Charge revenue between entry and exit. Ofgem reached the conclusion that this would be desirable but recognised that systems implications would prevent its implementation prior to October 2002.

Transco decided to raise Modification Proposal 0532 as the Network Code determines that "NTS Commodity Charges" at a storage site is only applied to gas consumed at that site.

2. Description of The Modification Proposal

The Modification Proposal was as follows:

"It is proposed that System Operator (SO) commodity charges be applied at all exit points from the National Transmission System. This is consistent with the proposals in Pricing Consultation paper PC70 which Ofgem decided not to veto.

At present, NTS commodity charges are applied in respect of all gas leaving the NTS at exit points from the National Transmission System, with the exception of storage sites. At storage sites commodity charges are only applied in respect of gas consumed at these sites for purposes such as process heating. Thus the majority of gas leaving the NTS at these sites is not subject to NTS commodity charges at the time it is transported to the storage site. It is proposed that the existing exception to application of NTS commodity charges should be removed, such that the proposed NTS SO charges would in future apply in respect of gas transported to all sites, including storage sites.

Transco proposes that this should be on the same basis at all sites and hence be applied to User Daily Quantity Outputs (UDQOs). Providing no User has made an entry nomination (ie associated with storage withdrawal nomination) on the same day, the sum of UDQOs will equal the physical quantity of gas off-taken at the storage site. Transco believes that even if there were entry nomination(s) in respect of the storage facility's entry point, applying the SO commodity charges would still better achieve the relevant objectives. It would, however, welcome representations in

respect of alternative principles for applying the SO commodity charges that are consistent with the objectives of PC70. "

The intention of the Modification Proposal was to embody the principles of PC70 within the Network Code. There was no intention to continue or re-open the debate on any of the issues raised within the representations in respect of PC70 as reflected in Transco's report or in the views detailed in Ofgem's decision letter. The only issue identified by Transco that was not resolved in the pricing consultation process was the details on how the charge might be applied in respect of flows to storage sites.

3. Workstream Discussion

3.1 PSS Discussions

Prior to issuing the Modification Proposal, Transco discussed the issues within the Planning and Security (including Storage) Workstream (PSS). The discussion centred on two issues:

- The suitability of UDQOs for the application of the SO commodity charge. One alternative discussed in PSS was to pay rebates to shippers withdrawing gas from storage on that same gas flow day.
- The potential benefits of delaying implementation until the SO commodity charge was made in respect of both NTS entry and exit flows.

The Modification Panel noted that discussion had taken place at the PSS Workstream but decided that further discussion should take place at the Capacity Workstream. Discussion was subsequently held at the Workstream's RGTA meeting on 27 February 2002, the Capacity Workstream on 7 March 2002 and the RGTA meeting on 14 March 2002.

3.2 RGTA Workstream Discussions - 27/02/02

At this meeting Transco presented the background to the Modification Proposal and outlined four alternatives for determining the flow to which the SO commodity charge might be applied and invited discussion on those alternatives or any other alternatives that attendees might like to discuss. No alternatives were raised but a number of other issues were discussed. These were as follows:

- Phasing of implementation of this Modification Proposal
 - This was based on the assumption that from October 2002 the SO commodity charge would be applied on the basis of entry and exit flows.
- Locational aspects
 - This was based upon the view that Transco's SO costs would be related to the distance between the entry and the exit point.
- Linepack issues
 - It was argued that storage fulfils a similar function to NTS linepack but no proposal has been made to apply the SO commodity charge to line-pack
- Contribution of storage to system security
 - It was argued that the contribution storage makes to system security should be recognised in terms of a lower or zero commodity charge. If this were not done the viability of storage would be affected to the detriment of the community as a whole.
- Interconnector Issues
 - It was argued that the issues applying to calculation of flows at storage sites apply equally to Interconnectors where flow can be in either direction. Compatibility of treatment should be addressed in any Modification Proposal.
- Flow-through of storage charges to end-user prices

- It was argued that due to the nature of storage, end-user prices would be particularly sensitive to storage charges.

At the close of the discussion, Transco placed these six main points on a flip chart and asked for confirmation that they identified at a high level the discussion that had taken place. This was agreed by those present.

Taking each point in turn the discussion highlighted the following issues:

- It is at present only a suggestion that SO commodity charge be applied to both entry and exit. The consultation on such a change would not necessarily result in its implementation. In contrast the principles behind PC70 have been through the full pricing consultation process, including the Ofgem decision not to veto the proposal.
- The locational aspect of the prospective SO commodity charge was discussed within the representations to PC70 and Transco had requested specific comments on this. There is a trade-off between simplicity and cost reflectivity and Ofgem pointed out that the representations favoured the simple alternative ie a standard commodity rate. It was pointed out in the discussion that locational aspects of SO costs apply to all exit flows not just to storage sites.
- Transco has no plans to introduce a linepack service. It was therefore suggested at the Workstream that if such a service were introduced, the application of commodity charges to linepack might then be discussed.
- The discussion included reference to capacity charges where storage tends to have an advantage over other sources of gas. Whilst recognising the role that storage plays in providing system security, demand side management is an alternative in some cases and the same arguments could apply there.
- Gas flowing into Interconnectors is presently charged on the basis of UDQOs. Transco has, however, summarised four alternatives for storage and recognises the argument that compatibility should be maintained.
- Transco and other Workstream attendees had some difficulty in assessing whether end-user pricing is particularly sensitive to storage related costs. In general, a competitive market tends to ensure that all costs and benefits, arising from changes, flow through to the end-user.

3.3 Capacity Workstream Discussions - 07/03/02

In its general review of Modification Proposals, members of the Workstream expressed the view that whilst there had been discussion on the general concepts behind PC70, there had not been sufficient debate of the four alternatives presented by Transco at the RGTA Workstream. Transco offered to place the subject on the agenda of the RGTA Workstream on 14 March 2002 but based on its view of the conclusions reached on 27 February 2002, it made a recommendation to the Modification Panel that the Modification Proposal could go to consultation. The Modification Panel voted against this recommendation wishing to await the discussions on 14 March 2002.

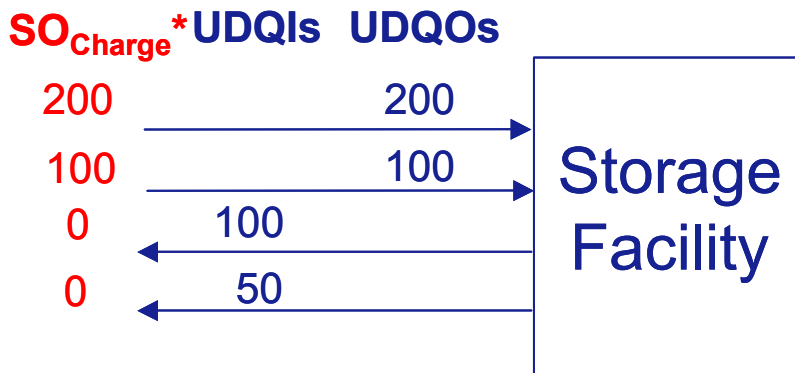
3.4 RGTA Workstream Discussions - 14/03/02

At this meeting five alternatives were discussed. Transco made it clear that whilst the principles would not be further debated on that occasion, parties were encouraged to make written representations in respect of these as part of the normal process. In addition to the four alternatives outlined by Transco on 27 February 2002, Dynegy outlined a fifth alternative to charge SO commodity on the basis of UDQOs but to rebate inputs to the system due to storage withdrawals by applying to UDQIs an SO commodity credit of the same magnitude as the charge. To ensure consistent discussion of each alternative, the advantages, disadvantages and other features of each alternative were recorded and discussed. The same flow example was also used throughout.

Alternative 1: UDQOs

This was the base case alternative. This would allocate the commodity charge on the basis of UDQOs without any adjustment. The example given was as follows:

4 Shippers: 2 Injecting, 2 Withdrawing



Net flow into Storage Facility = 150

Calculations:

- Commodity charge income:
 - SOCharge * 300
- "Additional" income reflected in lower SO commodity charge in future years

The advantages, disadvantages and other features were as follows:

Advantages

- Simple
- Consistent with Energy Balancing Cash-Out
- Consistent with treatment of interconnectors

Disadvantages

- Not reflective of actual flows into/out of storage
- May discourage use of storage facilities due to increased costs for storage users
- Discriminatory - storage users subsidise non storage users

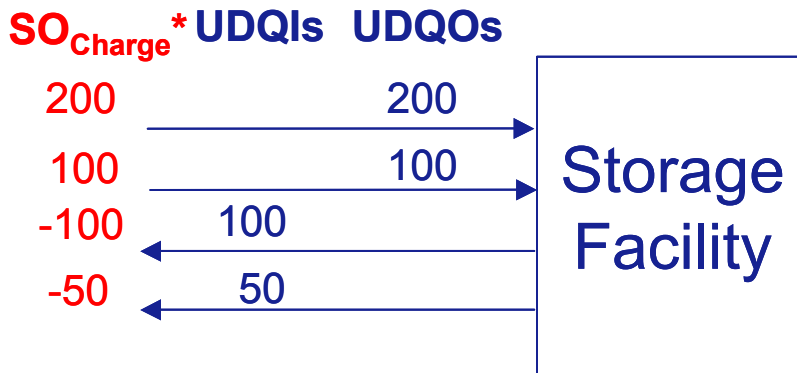
Other Features

- Redistributive effect on charges for following SO charge period(s)

Alternative 2: UDQOs + Rebates

This differed from alternative 1 in that a rebate would be paid to users who were withdrawing gas from storage on that Gas Flow Day

4 Shippers: 2 Injecting, 2 Withdrawing



Net flow into Storage Facility = 150

Calculations

- Commodity charge income:
 - SOCharge * 300
- Rebate based upon UDQIs:
 - SOCharge * (-150)
- "Withdrawers" benefit pro-rata to UDQIs

The Workstream assumed that charging would be on a unit basis and that this methodology would only apply where the sum of the UDQOs exceeded the sum of the UDQIs (ie there was a net inflow into the storage facility). Where there was a net outflow no charge would be applied.

The advantages, disadvantages and other features were as follows:

Advantages

- Reflective of actual flows

Disadvantages

- Encourages gas counter flows (the view of some Workstream participants only)
- Uncertainty about costs as a result of within day variation of nominations
- Individual shippers not charged in proportion to their physical flow
- Inconsistent with treatment of interconnectors

- Discriminatory

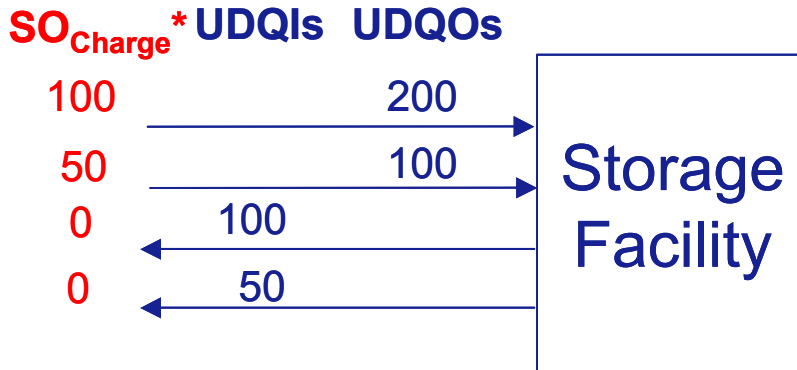
Other Features

- Payment of rebates is a pricing methodology issue that would require further pricing consultation

Alternative 3: Pro-Rated UDQOs

This differed from alternative 1 in that users who were injecting gas into storage on that Gas Flow Day would be charged on less than their UDQOs

4 Shippers: 2 Injecting, 2 Withdrawing



Net flow into Storage Facility = 150

Calculations

- Commodity charge income:
 - SOCharge * 150
- "Injectors" charged pro-rata to UDQOs

The Workstream assumed that charging would be on a unit basis and that this methodology would only apply where the sum of the UDQOs exceeded the sum of the UDQIs (ie there was a net inflow into the storage facility). Where there was a net outflow no charge would be applied.

The advantages, disadvantages and other features were as follows:

Advantages

- Reflective of actual flows

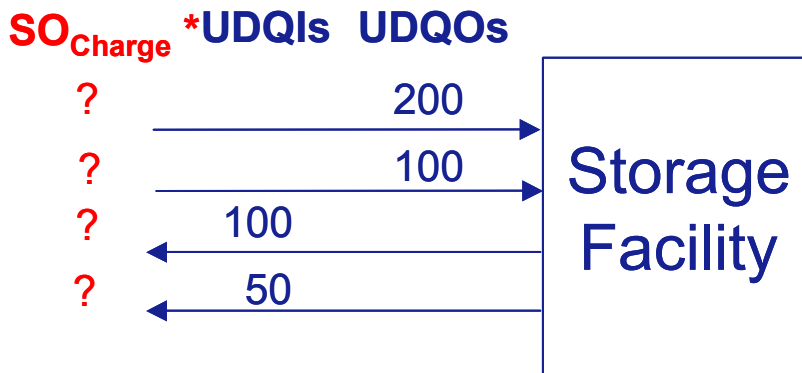
Disadvantages

- Uncertainty about costs as a result of within day variation of nominations
- Inconsistent with treatment of interconnectors
- Discriminatory
- A shipper would be charged where its UDQI exceeded its UDQO (for example due to a within-day reversal of nomination)

Alternative 4: Storage Operator's Notifications

In this alternative the Storage Operator would notify Transco of the allocation for each Gas Flow Day. Transco would accept these notifications providing the sum of these equalled the net flow into the storage facility.

4 Shippers: 2 Injecting, 2 Withdrawing



Net flow into Storage Facility = 150

Calculations

- Commodity charge income:
 - $SOCharge * 150$
- Storage Operator informs Transco how "150" is allocated for SO commodity charge purposes

The advantages, disadvantages and other features were as follows:

Advantages

- Responsibility vested in those using system for storage injections/withdrawals

Disadvantages

- Lack of transparency
- Inconsistent with treatment of interconnectors

Other Features

An alternative approach would be to charge the Storage Operator and allow this person to recover this in storage charges

Alternative 5: Net Of Annual UDQOs and UDQIs

This alternative was tabled by Dynegy at the meeting. No diagram was presented but the concept was understood. Users would be charged on the basis of the sum of their UDQOs but would receive a rebate based on the sum of their UDQIs. The same rate would be applied to both the charge and the rebate. This would mean in terms of net charge/rebates that a User that injected more gas into storage than it withdrew would face a net cost but a User that withdrew more than it injected would receive a net income. If withdrawals across the board equalled injection there would be no net income for gas transported to storage facilities. This is similar to the present situation where Users only pay in respect of gas consumed or vented on site.

The advantages, disadvantages and other features were as follows:

Advantages

- Simple
- Encourages effective cycling of storage quantities and use of options contracts

Disadvantages

- Against the spirit of the PC70 decision
- Discriminatory - non storage users subsidise storage users

Other Features

- Payment of rebates is a pricing methodology issue that would require further pricing consultation
- Redistributive effect on charges for following SO charge period(s)

4. Conclusion

The Workstream concluded that it required another opportunity to consider Alternative 5 prior to being in the position where it could recommend proceeding to consultation. The view, however, was expressed that providing time for debate should not result in any further delays to implementation of PC70 and progress was required. Transco offered to find space in the agenda on 21 March 2002 (pm). To facilitate progress it was agreed:

- The Workstream would discard alternatives 2 and 4 from further consideration (although this would not prevent Users favouring them in their representations.)
- Any further alternative suggestions should be sent to Transco by 20 March 2002 so that Workstream members would be able to consider them prior to the meeting.
- The Modification Panel on 21 March 2002 (am) would be advised of the meeting to be held on that afternoon further to discuss the Modification Proposal. The Panel would also be advised that it was the Workstream's aspiration to completed development of the Modification Proposal that afternoon so that it would be able to request a Panel vote on the recommendation to proceed to consultation.