

**Draft Modification Report**  
**Recovery of Financing Costs for Operating Margins Gas**  
**Modification Reference Number 0523**

Version 2.0

This Draft 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**

It is proposed to amend the Network Code so that Transco may recover the financing costs that it incurs in making quantities of gas available for Operating Margins (OM) purposes.

It is proposed that for each day Transco would be entitled to recover an amount equal to:

$(\text{Weighted Average Cost of OM gas-in-storage}) * (\text{Neutrality Interest Rate})$

where:

- a. Weighted Average Cost of Gas includes all costs associated with the procurement, delivery and injection of gas into storage (excluding Storage Space charges);
- b. Neutrality Interest Rate means: the percentage rate calculated as the base rate for the time being of Barclays Bank plc divided by 365.

It is proposed that the OM financing costs would be included in the calculation of the Daily Margins Recovery Amount which is included within the balancing neutrality provisions of the Network Code.

## **2. Transco's Opinion**

Section K of the Network Code requires Transco to procure Storage Space and fill that space with sufficient quantities of gas to satisfy OM requirements in relation to a Storage Year. In doing so, Transco incurs financing costs for which it is not compensated.

Transco receives an operating expenditure (opex) allowance within its price control to fund the procurement of Storage Space for OM purposes. However, under existing Network Code arrangements Transco only recovers the cost of OM gas and other associated costs such as storage injection and withdrawal charges when and to the extent that OM gas is used. Financing costs are excluded from this process and as a result Transco receives no funding for the costs of financing an investment of approximately £9m in OM gas.

Transco believes that a precedent has already been set for the recovery of OM financing costs. Previously, Section K5.4, version 2.00 (31 May 1998) of the Network Code allowed Transco to recover the financing costs it incurred in making sufficient quantities of Balancing Margins gas available in each Storage Year. Transco believes that its obligations in relation to the use and procurement of gas for Balancing Margins purposes were akin to its current obligations in

relation to OM. Therefore, Transco believes that it should recover the financing costs it incurs in the provision of OM gas.

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

Transco believes that this Modification Proposal would be consistent with Section 4AA(2)(b) of the Gas Act 1986 (as amended by the Utilities Act 2000) which requires that Transco is allowed sufficient funding to finance its activities in operating the gas transmission system.

Consequently, Transco believes that this Modification Proposal is consistent with Special Condition 3(1) of Transco's GT Licence, i.e. that Transco should secure sufficient financial facilities to enable it to carry on the transportation business. Consistency with Special Condition 3(1) satisfies Transco's relevant objectives as defined by Standard Condition 9 of Transco's GT Licence which requires the efficient discharge of Transco's obligations under the GT Licence.

**4. The implications for Transco of implementing the Modification Proposal , including  
a) implications for the operation of the System:**

Transco is not aware of any implications for the operation of the System.

**b) development and capital cost and operating cost implications:**

Transco is not aware of any development, capital or operating costs which would arise from the implementation of this Modification Proposal.

**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:**

Not applicable.

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

Transco is not aware of any consequences that this proposal would have on price regulation.

**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**

This Modification Proposal would not affect Transco's contractual risk under the Network Code.

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

Transco is not aware of any implications for Transco and related computer systems of Users.

**7. The implications of implementing the Modification Proposal for Users**

Users would be required to reimburse Transco in relation to the financing costs it incurs in providing OM gas. The exact cost to Users would be dependent upon the volume and price of gas stored by Transco for OM purposes. However, Transco believes that the financing costs that it seeks to recover would be in the range of £750k to £1m per annum. The OM financing costs would be apportioned between Shippers using Balancing Neutrality Charges as defined in Section F4 of the Network Code.

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

Transco is not aware of any implications for Terminal Operators, Consumers, Connected System Operators, Storage Operators, suppliers, producers or any non-Network Code party.

**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 affect on the legislative and regulatory obligations and contractual relationships of Transco and each User and non-Network Code party of implementing the Modification Proposal.

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

Transco believes that the advantages of implementing this Modification Proposal are:

- Compliance with Section 4AA(2)(b) Gas Act 1986 (as amended by the Utilities Act 2000) which requires that Transco is allowed sufficient funding to finance its activities in operating the gas transmission system.
- Adherence to Special Condition 3(1) of Transco's GT Licence, i.e. that Transco should secure sufficient financial facilities to enable it to carry on the transportation business.
- Consistency with Standard Condition 9 of Transco's GT Licence which requires the efficient discharge of Transco's obligations under the GT Licence.

If this Modification Proposal is implemented Users' operating costs would increase and this may be perceived as being a disadvantage. However, Transco believes that the impact on

Users would be not be significant. The OM financing costs are not substantial and the cost would be shared between all Users.

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

Transco now seeks representations in respect of this Modification Proposal.

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

With the exception of the legislation referred to above, Transco does not believe that implementation of this Modification Proposal is required to facilitate compliance with safety or other legislation.

**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 does not believe that this Modification Proposal is required in respect of any proposed change in the methodology established under Standard Condition 4(5) of the statement; furnished by Transco under Standard Condition 4(1) of the Licence.

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

Transco is not aware of any programme of works that would be required as a consequence of implementing the Modification Proposal.

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

It is proposed that Transco would recover OM financing costs from Users as of 1 April 2002. Transco is not aware of any systems changes that would be required as a result of this Modification Proposal.

**16. Recommendation concerning the implementation of the Modification Proposal**

Transco recommends that this Modification Proposal is implemented with effect from 1 April 2002.

**17. Text**

**SECTION K: OPERATING MARGINS**

*Change heading to paragraph 4.3 to read 'Daily Margins Recovery Amount and Financing Costs'.*

*Amend paragraph 4.3.2 to read as follows:*

" ....

(i) ....Net Margins WACOG;

(ii) ....in respect of the Day; and

(iii) the amount of the Margins Gas Financing Cost for the Day in accordance with paragraph 4.3.5."

*Add new paragraph 4.3.5 to read as follows:*

"4.3.5 **"Margins Gas Financing Cost"** in respect of a Day is the amount calculated as the sum, for all Storage Facilities, of the aggregate amount of gas-in-storage held by Transco (Margins) on that Day for Operating Margins Purposes, multiplied by the Net Margins WACOG, multiplied by the Neutrality Interest Rate for the Day."

***Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report***

Signed for and on behalf of Transco.

Signature:

**Tim Davis**  
**Manager, Network Code**

Date: