

Draft Modification Report
Restoration of Funding for National Top-up
Modification Reference Number 0472

Version 1.0

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

The Modification Proposal was as follows:

"Network Code provisions require Transco, as Top-up Manager, to book and fill storage capacity in order to meet the 1-in-20 peak day and 1-in-50 severe year security criteria for national supply/demand. Transco proposes that the net costs of this should be recovered from Users through the Top-up neutrality mechanism.

Part of the national requirement may already have been provided through Constrained Top-up. The present proposal only applies to the costs of the remaining national Top-up requirement."

The Justification within the Modification Proposal was as follows:

"When the Network Code was first developed, it was generally agreed that it was desirable for gas to be available in storage in order to help provide security of supply. Where bookings were not adequate to deliver this, additional bookings should be made (top-up). The outcome incorporated in Section P of the Network Code involved Transco acting as Top-up Manager. Arrangements were also included such that any net costs would be passed through to Users in accordance with a Top-up neutrality mechanism.

Transco's Safety Case includes Top-up as part of the safety regime, and refers to Standard Condition 31(9) of the Gas Supplier Licence. That condition requires a Supplier to either meet domestic supply security standards in relation to their domestic customers, or secure that gas conveyed by public gas transporters for supply to domestic customers is conveyed in conformity with those transporters' network codes. Standard Condition 31(10) of the Supplier Licence defines domestic supply security standards i.e. supplies must be sufficient to meet 1-in-20 peak day and 1-in-50 severe year demands. Standard Condition 7 (1) (d) of the Public Gas Transporter Licence requires the transporter to establish a network code calculated (inter alia) to provide "reasonable economic incentives for relevant suppliers to secure that the domestic supply security standards (within the meaning of condition 31(10) of the Standard Conditions of Gas Supplier Licences) are satisfied as respects the

availability of gas to their domestic customers", and Top-up is part of the arrangements through which Transco meets this condition.

The Network Code obliges Transco as Top-up Manager to book and fill available storage on a national basis, as necessary to meet the 1-in-20 peak day and 1-in-50 severe year security of supply criteria. Ofgem has previously argued that Top-up is not necessary, and Transco should be pro-active in seeking to remove its Top-up related obligations. Consistent with this view, Transco was directed to implement Modification Proposal 0297, which removed the Top-up cost recovery mechanism from the Network Code.

In light of Ofgem's position, Transco has sought to remove or reduce the Top-up obligations in the Network Code and its Safety Case. However, the HSE has made it clear that it will not accept any amendment to the Safety Case which involves such a reduction, as this could reduce system security levels.

Given the continuing existence of the Safety Case reference and the Network Code obligation to book and fill storage, assuming Users have not done so to the level expected to be sufficient to maintain supplies on a 1-in-20 peak day or in a 1-in-50 severe year, Transco believes it is appropriate that the funding arrangements should be reinstated. This Modification therefore proposes reinstatement of the previous Top-up neutrality mechanism that was originally included in Section P of the Network Code.

While Transco proposes returning to the previous mechanism for allocating any Top-up costs between Users, it recognises that some concerns have been raised in the past about the continuing appropriateness of this method of cost recovery. Transco would welcome alternative proposals for how these costs should be shared between Users."

2. Transco's Opinion

Transco believes that the costs of unavoidable obligations, such as Top-up, should be reflected in the level of income it is permitted to collect from Users and therefore this proposal should be implemented.

When the Network Code was originally written, it was agreed in discussion on security of supply that Top-up storage might be required, and should be funded by Users through the Top-up Neutrality mechanism. After discussions on the most appropriate body to administer Top-up arrangements Transco agreed to take on this role provided it was funded by Users.

Implementation of Modification Proposal 0297 removed this funding. Ofgas stated in its implementation letter that Transco should bring forward proposals which it expected at the time would remove/reduce Top-up requirements.

The HSE has not agreed to the removal of Transco's Top-up obligations from its Safety Case. However, at a meeting of Ofgem, HSE and Transco in November 2000, the HSE agreed to consider whether Top-up requirements could be reduced to safeguard domestic demand rather than all firm demand. Accordingly, Transco proposed an amendment to its Safety Case and put forward Network Code Modification Proposal 0449. However, after obtaining legal advice, the HSE concluded that such a change would be inconsistent with the 1996 Gas Safety (Management) Regulations. Transco therefore withdrew its Modification Proposal.

Since Transco's proposals to remove or reduce Top-up requirements have not been accepted - contrary to Ofgas' expectation when implementation of Modification Proposal 0297 was directed - the funding of Top-up should now be restored.

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

The provision of Top-up should be consistent with "the provision of reasonable economic incentives for relevant suppliers to secure that the domestic supply security standards ... are satisfied as respects the availability of gas to their domestic customers". One of the reasonable economic incentives is provided by accepted Top-up offers on the OCM setting appropriate System Marginal Buy Prices in severe weather conditions. However, this incentive would be reinforced by Users having to fund Top-up if their own storage bookings did not in total meet the security criteria determined under the "storage monitor" arrangements. Whilst this incentive would not be entirely focussed it would still provide a general incentive on all applicable Users.

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

Implementation of this Modification Proposal would increase the incentive on Users to book storage. This would lead to reduced usage by Transco of Top-up for daily system balancing during severe weather conditions.

b) development and capital cost and operating cost implications:

Transco does not anticipate significant development or operating cost implications as a result of 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:

Any costs associated with implementation would be treated as normal business costs with no additional cost recovery proposed.

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

Transco is not aware of any impact 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

The level of contractual risk would be expected to reduce as Transco would no longer be meet the cost of funding Top-up.

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

Transco is unaware of any implications for computer systems as the Modification Proposal would reintroduce previous invoicing processes.

7. The implications of implementing the Modification Proposal for Users

Costs for the 2001/02 Storage Year would be recovered with reference to Users' UDQOs at firm supply points for the months December 2001 to March 2002 inclusive, and similarly in subsequent Storage Years.

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

Users may seek to pass Top-up costs on to Suppliers and Consumers.

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

Funding of Transco's obligations would be reinstated.

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

Advantages

Consistency between regulatory obligations and funding.

Disadvantages

Top-up costs would not be focussed on those Users causing them by under-providing peak gas for their demands, however as noted in 4(c) Transco is open to alternative proposals.

Changes to the storage regime would be made within the 2001/02 Storage Years after Users had made storage booking decisions based upon the current storage regime. This is not, however, unprecedented.

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

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

The funding of National Top-up is consistent with facilitation of Transco's compliance with its Safety Case.

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 works.

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

The following timetable has been identified:

Close-out for representations: 29/11/01

Final Modification Report issued: 06/12/01

Ofgem decision expected: 13/12/01

Implementation: 14/12/01

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends implementation of this proposal.

17. Text

SECTION P: TOP-UP STORAGE

Amend paragraph 6.4.1 to read as follows:

"The difference between the costs and revenues of the Top-up Manager is payable to or recoverable from relevant Users in the Top-up Recovery Period in accordance with this paragraph 6.4."

Amend paragraph 6.4.3 to read as follows:

"Each relevant User shall pay to the Top-up Manager, or (as the case may be) the Top-up Manager shall pay to each relevant User, a charge ("Top-up Neutrality Charge") calculated:

- (a) in respect of each Day in the Top-up Recovery Period, as the Top-up Daily Recovery amount divided by the sum of all the relevant UDQOs for the Day multiplied by the sum of the relevant Users relevant UDQOs for the Day:
- (b) in respect of calendar month after the Top-up Recovery Period, as the Top-up Recovery Adjustment Amount for the preceding month divided by the aggregate sum of all relevant Users' relevant UDQOs for each Day in the Top-up Recovery Period multiplied by the sum of the relevant User's relevant UDQOs for each Day in the Top-up Recovery Period."

Insert new paragraph 6.4.4 to read as follows (and renumber existing paragraph 6.4.4 as paragraph 6.4.5):

"The top-up Neutrality Charge shall be payable by the Top-up Manager to the User where it is negative and by the User to the Top-up Manager where it is positive."

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: