Modification Report
Treatment of Constrained Top-up Costs for Storage Year 2001/02
Modification Reference Number 0451

Version 3.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

Transco proposes continuation of the Constrained Top-up cost recovery arrangements established by implementation of Modification Proposal 0391, for a further year commencing 1st May 2001.

2. Transco's Opinion

Transco believes that its PGT Licence obligation to meet peak transportation requirements should be funded properly. These requirements are met in part through the use of Constrained LNG. To the extent that shippers do not book sufficient Constrained LNG service, Transco does so as Top-up Manager, to meet its Licence and Network Code obligations, and therefore should be funded. Top-up Neutrality is an established and appropriate method of funding.

Transco supports extending the present arrangements on a time limited basis since revised arrangements for 2002 can be considered as part of Transco's Periodic Review.

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

Constrained LNG is the most economic and efficient method of providing part of the capacity required to meet 1-in-20 peak day demand in certain geographical areas. If this Modification Proposal is not implemented, Transco will be required to fund any shortfall in Constrained LNG bookings, whereas alternative pipeline investment can be included in the Regulatory Asset Base and earn an appropriate return. This could be regarded as a perverse incentive on Transco to invest in new pipeline capacity rather than utilise existing LNG assets. Such investment might conflict with Standard Condition 7(1)(a): the efficient operation by the licensee of its pipeline system. Therefore the proposed modification better facilitates this relevant objective.

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

a) implications for the operation of the System:

There are no implications for operation of the System.

b) development and capital cost and operating cost implications:

There are no development or capital cost implications.

If this Modification Proposal is implemented, Transco would still be responsible for financing the initial purchase of storage services and gas, however it would recover these costs within a year through Top-up Neutrality charges levied in respect of the December to March (inclusive) winter period.

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:

Recovery of Constrained Top-up costs as contemplated by this proposal is appropriate, for the reasons given under "Transco's opinion" above.

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

Implementation of this Modification Proposal would have no effect 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

Implementing this Modification Proposal would reduce the level of contractual risk faced by Transco under the Network Code for Storage Year 2001/02, because it would remove the exposure to Constrained Top-up costs. These costs arise to the extent that users do not book and fill sufficient Constrained LNG to meet Transco's transmission support requirements.

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

There are no development or other implications for the computer systems of Transco or for the related systems of Users.

7. The implications of implementing the Modification Proposal for Users

Users rather than Transco would bear any Constrained Top-up costs arising in Storage Year 2001/02. Any such costs would be shared in proportion to firm UDQO's over the winter period of December 2001 to March 2002 inclusive, in accordance with the established Top-up Neutrality apportionment methodology.

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 unaware of any such implications.

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

Implementation of this Modification Proposal would maintain the financing of Transco's licence obligations to provide transportation capacity sufficient for 1-in-20 peak demands.

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

Advantages:

Implementation would:

- Allow Transco to recover costs not provided for under the current revenue control but permitted under Special Condition 9C of Transco's PGT Licence;
- Avoid undue contractual risk to Transco;
- Avoid inappropriate investment signals and so discourage potentially uneconomic and inefficient investment in pipelines.

Disadvantages:

Implementation would:

- Increase Users' exposure to smeared costs.

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

Five representations were received.

Four shippers, Yorkshire Energy, Northern Electric & Gas (NE&G), Aquila and Scottish Power aknowledged the necessity of this proposal. All of these refer to Ofgem's intention to review LNG arrangements in the longer term, but consider implementation of the proposal to be an appropriate interim solution for Storage Year 2001/02, since this review has not been completed. NE&G include the proviso that Ofgem should "closely monitor Transco's actions to ensure that any costs are efficiently incurred".

<u>Transco's response</u>
Transco welcomes this support for the proposal. Transco looks forward to the publication of Ofgem's initial proposals for the exit regime, interruptibles and LNG, and will work with Ofgem and shippers to seek a longer term solution. NE&G's comment on efficiently incurred costs reflects the linkage with the method for selling LNG capacity that Ofgem made in their decision document for the Storage Year 2000/01 arrangements, and Transco would expect Ofgem to apply similar criteria this year.

One shipper, BGT, opposes the proposal for the same reasons they opposed Modification Proposals 0356 and 0391:

1. BGT refers to earlier Ofgas documents, in particular Ofgas' 1998 Review of Top-up, in which Ofgas said Transco should bear the costs of constraints / Top-up bookings;
2. BGT points out that cost recovery would remain unfocussed, and not target those shippers failing to make adequate peak gas provision, and not contributing to local transmission needs by booking Constrained LNG;
3. BGT says the proposal gives Transco no incentive to optimise Top-up costs or capital expenditure.

BGT expresses disappointment that, during the year since Modification Proposal 0391 was approved, Transco has not considered the sharing of costs between it and shippers, or the redistribution of costs between shippers as discussed in point 2 above.

BGT also says that, if LNG auction arrangements remain substantially as in 2000/01, there may well again be no requirement for Constrained Top-up.

<u>Transco response</u>
In response to the numbered points:

1. Transco believes Ofgas' earlier comments partly reflect its views on National as opposed to Constrained Top-up. Transco considers Ofgem's report on LNG arrangements for 2000/01 reflect Ofgem's latest view, and the decisons made there remain appropriate as an interim solution.
2. Transco acknowledges that focussing of National Top-up costs remains an issue, but no viable solutions have been found. Shippers contributing to local transmission needs by booking Constrained LNG are compensated through the transportation credit they receive and, if inadequate, this credit could be increased, rather than introducing additional complexity into the Top-up regime. Further, in 2000/01 shippers were able to bid for LNG capacity knowing the

transportation credit, and the low or zero effective reserve price enabled them to freely bid their value.

3. As mentioned previously, exposure to Constrained Top-up costs could incentivise Transco to prefer investment in new pipeline capacity to utilisation of existing LNG assets, and this would be inefficient. The proposal on the other hand puts Transco in a position where it has no particular incentive to prefer one source of capacity over the other, since it is unaffected by the costs of using Constrained LNG, and is broadly neutral to incremental pipeline investment if it receives a fair return.

Transco does not believe the sharing of Constrained Top-up costs between it and shippers would be appropriate, since this would forego the advantages of the proposal, albeit partially. As indicated above, the cost focussing issue is not relevant to Constrained Top-up, and no satisfactory solution is likely to be found as regards National Top-up (and in any case Transco currently bears the costs of the latter).

Transco agrees that, if the arrangements for selling LNG capacity are substantially as last year, it is likely that no Constrained Top-up costs will arise.

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

Implementation of this Modification Proposal is not 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

Implementation of this Modification Proposal would not change the methodology established under Standard Condition 3(5) of the Licence.

14. Programme of works required as a consequence of implementing the ModificationProposal

Regardless of implementation of this Modification Proposal, Transco is required to establish any Constrained Top-up requirements and to procure storage capacity, procure and inject gas, and identify Constrained Top-up costs.

If this Modification Proposal was implemented, Transco would additionally calculate and invoice any Top-up Neutrality charges applicable to the winter period, consistent with established methodology and using existing systems.

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

Transco proposes that this Modification Proposal should be implemented with effect from 1 May 2001. Users should be advised of the decision to implement by the time Transco LNG issues its Annual Storage Invitation on / before 1 March 2001, such that they have relevant information necessary to inform consideration of potential Constrained LNG bookings.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends this Modification Proposal should 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

MODIFICATION 0451

TREATMENT OF CONSTRAINED TOP-UP COSTS FOR STORAGE YEAR 2001/02

Proposed legal text

TRANSITION DOCUMENT, PART II

Amend paragraph 8.12 to read as follows:

"Section P: Top-up Storage

P6 (1) Paragraphs (2) to (6) shall apply in respect of the Storage Years commencing 1 May 2000 and 1 May 2001 ("**relevant**" Storage Years).

(2) ...".

Signed for and on behalf of Transco.

Signature:

Tim Davis
Manager, Network Code

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 **0451**, version **3.0** dated **27/02/2008**) 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 **3.0**.

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 <u>(whether such approval is actual or deemed by effluxion of time)</u> 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, <u>had it not been repealed, would</u> 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) <u>or 2(2)(b)(ii)</u> 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.