

**Final Modification Report**  
**Modification Reference Number 0356**

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:**

This Network Code Modification Proposal is to enable Transco to recover its costs for the provision of Constrained Liquefied Natural Gas (CLNG) Top-up for the Storage year 1999/2000, with the cost of this service being recovered from Users through application of the Top-up neutrality apportionment methodology. The method of recovery for 'national' Top-up would remain unchanged.

**2. Transco's opinion:**

The provision of CLNG ensures the availability of the required amount of transmission capacity to points at the extremities of the system close to centres of high demand. Transco achieves this by constraining Users' gas in CLNG facilities and giving them a discount on their entry charges at these facilities. Transco is obliged to make up any shortfall in Users' CLNG bookings by booking Constrained Top-up itself. The aggregate of the constrained LNG bookings must be sufficient to satisfy the 1 in 20 requirement. This obligation arises from both Transco's PGT licence and safety case.

Transco considers that the provision of transmission capacity using CLNG facilities continues to be the most economic solution for the provision of the 1 in 20 and 1 in 50 capacity requirement. Transmission constraints may be resolved by utilising existing LNG assets or alternatively by investing in additional pipelines. It is Transco's opinion that investment in additional pipelines and compressors would be uneconomic and at a disproportionate extra cost in circumstances where utilisation of existing LNG assets is a viable alternative.

Investment for the provision of appropriate capacity has already taken place in the form of LNG assets. Further investment in additional pipe may conflict with Transco's obligation under PGT Licence Standard Condition 7 (1) (a): the efficient and economic operation by the licensee of its pipeline system.

Transco believes that Users should bear the cost of CLNG Top-up for the following reasons:

At the time of the last price control review the Network Code provided for the recovery of Top-up costs reflecting both national and locational requirements. Hence it was anticipated that Transco would not bear Top-up costs. This was the case until implementation of Modification Proposal 0297. Transco is now paying directly for this substitute for transportation

capacity, without charge to Shippers. Transco believes that the intention of Modification Proposal 0297 was to challenge the need for national supply demand Top-up, which Transco believes merits consideration. Indeed, Transco is considering removal of references to Top-up from its safety case. However, Transco does not believe there was any intention to remove or reduce Transco's obligation in relation to the 1 in 20 and 1 in 50 security of supply criteria. Transco therefore considers that an unintended consequence of Modification Proposal 0297 is that Transco now bears all the costs of underwriting any shortfall of shippers' bookings in CLNG facilities. It was envisaged at the time of Transco's price control review that these costs would be met by Users.

The LNG facilities provide transmission support. In appropriate circumstances, constraining the LNG facilities to provide transportation capacity thereby avoids potentially uneconomic investment in pipeline and transmission assets. Such investment could give rise to significant costs which in turn could increase transportation charges to Shippers when these incremental assets are remunerated in line with current price control principles.

Whilst LNG facilities have been utilised to provide transmission support, Transco has continued to invest in the necessary pipeline and other transmission assets to satisfy demand growth on the system. This is demonstrated by the fact that the constrained element at CLNG facilities has not significantly changed despite firm load growth. This assertion is substantiated when the constrained requirement at the relevant LNG facilities is compared for the storage year 1996/1997 (at the beginning of the formula period) and the CLNG requirements for 1999/2000 (the Storage Year for which Transco seeks to recover its CLNG Top-up costs).

| Constrained levels - LNG sites | % of SPACE (less OM requirement) |               |                     |                  |
|--------------------------------|----------------------------------|---------------|---------------------|------------------|
|                                | Avonmouth space                  | Dynevor space | Isle of Grain space | Partington space |
| 1999/2000                      | <b>71</b>                        | <b>32</b>     | <b>65</b>           | <b>0</b>         |
| 1996/1997                      | <b>62</b>                        | <b>45</b>     | <b>72</b>           | <b>0</b>         |

CLNG allows Transco to be more flexible in connecting new loads in areas supported by CLNG facilities.

The investment signals to Transco are distorted at present since Transco receives no income for providing transmission support via CLNG.

The costs of CLNG have been efficiently incurred having been generated in accordance with Network Code rules.

Transco supports this modification for the recovery of CLNG Top-up costs for the storage year 1999/2000.

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

If shippers do not book sufficient quantities of CLNG, Transco is required through its Top-up manager role to book the balance required, as has occurred in the 1999/2000 storage year. As a result of Network Code Modification proposal 0297 'Top-up Cost Treatment', Transco is faced with meeting the cost of such bookings at the expense of its shareholders for the final three years of the existing formula.

This is inconsistent with the treatment of pipeline investment, on which Transco is allowed to earn a regulated return, and implies an incentive on Transco to invest in pipe rather than to utilise existing LNG assets. Such investment could conflict with Transco's obligation under PGT Licence Standard Condition 7 (1) (a): the efficient and economic operation by the licensee of its pipeline system.

Furthermore, special condition 9C permits Transco to provide Top-up on a neutral cost basis.

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

**a) implications for the operation of the System:**

There are no implications for the operation of the System.

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

Prior to implementation of Modification Proposal 0297, the costs of constrained Top-up were recovered from Shippers. The allowed costs in Transco's price control assumed that Transco would recover the costs incurred in the provision of transmission support via CLNG. As a result Transco is no longer receiving full financing for a licence obligation.

Implementation of Modification Proposal 0356 would allow Transco to recover the costs of providing transmission support via the CLNG service for the Storage Year 1999/2000. The cost of this service would be recovered from all Users in accordance with the existing Top-up neutrality apportionment methodology. The method of recovery for 'national' Top-up would remain unchanged.

**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:**

There are no implementation costs generated by this Modification Proposal.

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

This Modification Proposal would have no 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:**

Implementing this Modification Proposal would reduce the level of contractual risk to Transco under the Network Code for the Storage year 1999/2000, to the extent that Transco would recover the costs of providing transmission support through the Constrained LNG service. This is approximately £8m.

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

There are no implications that Transco is aware of. The functionality required to process any invoice amendments already exists within AT-link.

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

Individual Shippers will be exposed to a proportion of the total CLNG Top-up costs. Each shipper's proportion of the costs would be based on their UDQO's in accordance with the Top-up neutrality apportionment methodology, for the storage year 1999/2000.

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

There are no implications that Transco is aware of.

**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:**

The Modification would reestablish the correct financing obligations associated with existing licence conditions.

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

Advantages:

The Modification would allow Transco to recover money not provided for by its price control formula, but permitted under Special Condition 9C of Transco's PGT Licence.

The Modification would remove undue contractual risk to Transco.

The Modification would remove what could be regarded as a subsidy, paid for by Transco to the benefit of Shippers, for the provision of transmission capacity.

Transco would receive income for the provision of transmission support, thus removing potentially inappropriate investment signals.

**Disadvantages:**

Retrospective cost exposure to Shippers for CLNG Top-up costs and an inability for Shippers to revise bookings for the Storage year 1999/2000.

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

Representations have been received from three shippers, none of whom support this Modification Proposal.

Shell Gas Direct suggested that "...there is no evidence that this modification provides for an efficient and economic allocation of costs and both Shell Gas Direct and TXU suggested that the modification would reverse Ofgem's earlier decision about Modification 0297".

British Gas Trading suggested the following:

Transco's proposal for an unfocused smear of the costs between shippers is inappropriate and unfair as it fails to recognise that some shippers may have made full provision for their customers' needs while other shippers have not. This modification would introduce unfairness which does not currently exist between Shippers which would contravene the "relevant objectives" pertaining to Ofgem approval of Network Code Modifications.

Shippers have been paying high costs of delivery to the relevant exit zones. "These charges are designed to reflect LRMCs, but are payable for all firm gas delivered to those exit zones. So Transco have been collecting high LRMC-based charges to these customers and in seven years have not spent enough capital to close the gaps to LRMCs and charges elsewhere".

In response to Transco's assertion that due to Modification 0297 Transco bears the costs of any shortfall of shippers' bookings in CLNG facilities, the Shipper stated: "There is to our knowledge no shortfall of Shippers' bookings. It remains for Shippers to ensure that they provide sufficient resources for their customers."

"BG plc would have a clear incentive to overstate transmission support requirements where these could be addressed by CLNG services, as Transco would be indifferent to such costs and Transco LNG Storage would gain because Shippers would pay for additional use of under-utilised LNG sites".

"The smears would act for shippers as a discount to the prices of LNG services at Constrained locations, which would tend to make such sites more attractive in

relation to other storage sites owned by BG or their competitors where no such smear / subsidy would exist".

**Transco's Response:**

Transco believes that there is a strong economic case for utilising LNG assets for transmission support. This assertion is in line with the planning assumptions that have existed both before and during the current formula period. Transco's planning assumptions have made appropriate investment to support incremental load growth as demonstrated by the fact that the CLNG requirement has not significantly changed. Further, it is neither efficient nor economic to ascribe these costs to the pipeline operator given the propensity that such a course of action would have in encouraging alternative investment in pipeline and plant that would be remunerated via the price control.

The purpose of this Modification Proposal is to recover the cost of providing transmission support via CLNG by applying the existing Network Code Top-up Neutrality Apportionment Methodology. Transco recognises that it would be necessary to raise a separate Modification proposal to address the issue of the Top-up cost recovery method for forthcoming Storage Years.

Long run marginal costs (LRMCs) on the NTS will not necessarily change significantly as a result of new investment. LRMC based charges may influence the future pattern of supply and demand via price signals, thereby helping to encourage efficient development and utilisation of the NTS. It could have been regarded as inefficient for Transco to have invested in pipeline and plant as a substitute for the capability provided by existing LNG storage sites.

A consequence of the implementation of Modification Proposal 0297 was to remove the incentive for Shippers to book sufficient levels of CLNG. This resulted in insufficient CLNG bookings to secure that the domestic supply security standards were satisfied. This is indicated by the fact that there was no Top-up requirement during the Storage Year 1998/1999, whereas following implementation of Modification 0297 the aggregate of Shipper bookings of CLNG reduced dramatically, creating a substantial Top-up requirement, the costs of which have been inappropriately allocated to Transco. This is in direct conflict with Standard Condition 7(1)(d) of Transco's Licence which requires Transco to provide appropriate incentives to domestic Shippers to meet their domestic security standards. Standard Condition 7(1)(d) contemplates that Shippers should bear these costs.

Transco has not overstated the transmission support requirement in order to favour BG. Transco determines its incremental investment requirements on the assumption of no change in the dependence on CLNG. This is supported by the evidence which shows there has been no such increase. Further, implementation of this Modification Proposal would not incentivise Transco to overstate the CLNG requirement in the future since application of this Modification would be time limited.

The application of the Top-up Neutrality Apportionment Methodology would not make CLNG storage facilities more attractive to Shippers than its alternatives for two reasons. First, this Modification Proposal is time limited in effect and therefore no direct

incentive regarding future bookings is created. Second, Users cannot retrospectively restructure their Storage bookings in favour of the CLNG facilities.

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

As this Modification Proposal relates to storage year 1999/2000, there is no interaction between this and compliance with safety or other legislation. This modification is only concerned with cost recovery and does not impact on the level of CLNG required or the mechanism required to access it.

**13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:**

There is no proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence.

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

The cost of CLNG Top-up would be identified, individual User proportions calculated and users would be invoiced accordingly.

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

|                               |  |
|-------------------------------|--|
| Modification raised:          | 07/09/99   |
| Draft Workgroup Report:       | 25/10/99   |
| Draft Modification Report:    | 07/01/00 (Modification Panel granted an extension from 09/12/99) |
| Representations close out:    | 28/01/00   |
| Final Modification Report:    | 18/02/00   |
| Proposed implementation date: | 06:00hrs on 25/02/00   |

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

Transco recommends that this Modification Proposal be implemented as soon as possible.

**17. Text :**

## **Insert in Transition Document Part II**

### **Paragraph 8.21 Section P: Top Up Storage**

8.21. P For the Storage Year commencing 1st May 1999 , add paragraphs 6.4.5 to 6.4.9 shown below:

P6.4.5 In respect of Constrained Storage Facilities only, the difference between the Top-Up Costs and Top-Up Revenues of the Top-Up Manager incurred in respect of the Top-Up Manager is payable to or recoverable from relevant Users in the Top-Up Recovery Period as set out in paragraphs 6.4.6 to 6.4.9. below.

P6.4.6. (i) “Constrained Top -Up Daily Recovery Amount” shall mean the Top-Up Daily Recovery Amount applied in respect of Constrained Storage Facilities only.

(ii) “Constrained Top-Up Recovery Adjustment Amount” shall mean the Top-Up Recovery Adjustment Amount applied in respect of Constrained Storage Facilities only.

P6.4.7. 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 ("Constrained Top-Up Neutrality Charge") calculated:

(i) in respect of each Day in the Top-Up Recovery Period, as the Constrained Top-Up Daily Recovery Amount divided by the sum of all relevant UDQOs for the Day multiplied by the sum of the relevant User's relevant UDQOs for the Day;

(ii) in respect of each month after the Top-Up Recovery Period as the Constrained Top-Up Recovery Adjustment Amount for the preceding month divided by the aggregate sum of all



relevant User's 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.

P6.4.8 The Constrained Top-Up Neutrality Charge is 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.

P6.4.9 Constrained Top-Up Neutrality Charges shall be invoiced and are payable in accordance with Section S.

## **Insert in Transition Document Part II**

### **Paragraph 8.24, Section S: Invoicing and Payment**

8.24.11 For the Storage Year commencing 1st May 1999 insert in Annex S-1 5(1) add "and Constrained Top-Up Neutrality Charges".

Signed for and on behalf of Transco.

Signature:

**Tim Davis**

**Manager, Network Code**

Date:

**Director General of Gas Supply Response:**

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference 0356, version **4.0** dated **18/02/2000** be made as a modification to the Network Code.

Signed for and on behalf of the Director General of Gas Supply.

Signature:

The Network Code is hereby modified, with effect from \_\_\_\_\_, in accordance with the proposal as set out in this Modification Report, version **4.0**.

Signature:

**Process Manager - Network Code**

**Transco**

Date:

## **ANNEX**

### **Restrictive Trade Practices Act - Suspense Clause**

For the purposes of the Restrictive Trade Practices Act 1976, this document forms part of the Agreement relating to the Network Code which has been exempted from the Act pursuant to the provisions of the Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996. Additional information inserted into the document since the previous version constitutes a variation of the Agreement and as such, this document must contain the following suspense clause.

#### **1. Suspense Clause:**

1.1 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect:

(i) if a copy of the Agreement is not provided to the Director General of Gas Supply (the "Director") 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 Director 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 paragraph 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996.

provided that if the Director does not so approve the Agreement then Clause 1.2 shall apply.

1.2 Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which this Agreement or such arrangement is subject to registration under the Restrictive Trade Practices Act 1976 shall not come into effect until the day following the date on which particulars of this Agreement and of any such arrangement have been furnished to the Office of Fair Trading under Section 24 of the Act (or on such later date as may be provided for in relation to any such provision) and the parties hereto agree to furnish such particulars within three months of the date of this Agreement.