



15 May 1996

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Our Ref :

Your Ref :

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Dear Brian

Urgent Modifications - 0014 and 0019, and Shipper Modification request

We are now in a position to make a determination on the two remaining TransCo urgent modifications. We have also included in this letter our response to the modification request of 3 April proposed by seven shippers.

0014 - Margins and Top-up anomalies

We wrote to you on 1 May to indicate that we were not minded to approve this proposal, and to give an explanation of our reasoning. Subsequently Chris Train replied and we met with you on 7 May at Ofgas to discuss this modification. Our view has not changed and therefore the Director is not prepared to give a direction under paragraph 10(b) of Condition 7 of the Standard Conditions of the Gas Transporters' Licences in respect of modification proposal 0014.

In my letter I suggested that we would approve a modification similar to 0014 to correct the drafting anomaly prospectively from the date that the modification was submitted to Ofgas. TransCo first wrote to Ofgas on this matter on 2 April. You have suggested that TransCo might submit an alteration to modification 0014 effective from 1 April. We understand that your rationale for choosing 1 April rather than 2 April is that it helps avoid a mid month contractual amendment. Ofgas would be prepared to meet your request on the assumption that shippers are financially indifferent between the two dates (1 or 2 April). Please confirm that this would be the case, when you resubmit the modification.

A summary of our analysis is attached for shippers information - Appendix 1.

0019 - Retraction of Scheduling charges during March 1996

We wrote to you on 26 April setting out our analysis behind this proposal and indicating that we were not minded to approve modification 0019. Chris Train responded to the points we raised on 30 April. We are not persuaded that retracting scheduling charges during March is the right approach to take. Therefore the Director is not prepared to give a direction under paragraph 10(b) of Condition 7 of the Standard Conditions of the Gas Transporters' Licences in respect of modification proposal 0019.

A summary of our analysis is attached for shippers information - Appendix 2.

Modification request by seven shippers

We have attached a detailed paper which sets out our thoughts on this request - see Appendix 3. However, our views are also summarised below.

1. *TransCo to resolve portfolio discrepancies and information flow deficiencies.*

At this time we do not consider it appropriate to place any additional financial incentives on TransCo. However, if improvement does not occur we may reconsider our approach.

2. *Suspend invoice production for March pending satisfactory resolution of 1 above and amend credit terms if necessary.*

Ofgas is not prepared to direct TransCo to suspend March invoices. Reconciliation invoices have already been delayed and energy balancing invoices will be delayed until the CVA closes out inputs.

We would expect TransCo to take a pragmatic view on transportation credit terms while recognising that the Code specifies that credit is based on services tendered. Energy balancing credit terms are in place to manage the industry's exposure. Although facilitated by TransCo they represent an inter-shipper issue.

3. *Urgent actions.*

a) *No cash out:* Ofgas approved modification 0017 which recommends that cash out and reconciliation should be at the 30 day SAP.

b) *Imbalances and reconciliation quantities are resolved in a manner which results in no undue exposure to shippers:* Modification 0017 is aimed at achieving this.

c) *No smearing:* A consequence of not approving modification 0014 is that in March shippers will incur neutrality charges of $(£10m - £3.27m) = £6.73m$, while TransCo will incur $(£1.9m + £3.27m) = £5.17m$.

It is difficult clearly to identify where the fault lies for the problems experienced during March. Few shippers participated in the flexibility mechanism adding to the illiquidity and volatility, demand changes were not responded to and gas appeared to profiled on a flat load basis. During the same period TransCo's information flows were poor, and portfolios remained problematic. These facts and taking into account the size of the shipper smear, we have decided that as smeared charges are an agreed element of the Code it would set a wrong precedent to simply relieve shippers of smeared charges.

d) *No scheduling charges:* While concerns about adequate information from TransCo are generally frustrating to shippers, and certainly important in terms of daily balancing, it is not clear that the problems encountered significantly increase the exposure of shippers to scheduling charges beyond those contemplated in the soft landing period. Ofgas has therefore decided not to accept this proposal or approve TransCo's modification 0019 (see appendix 2).

e) *No capacity overruns:* . We do not think it reasonable to alleviate capacity overrun charges for March. It has been argued that due to inadequate information and portfolio problems booking capacity accurately has proved difficult. This is the same for all shippers and booking capacity is a matter of commercial advantage. Alleviating March capacity overrun charges would therefore have the effect of disadvantaging those shippers who had made adequate capacity provisions.

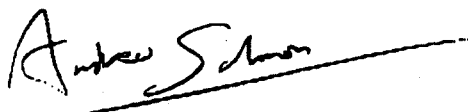
f) *CVAA - March M+15 close out to be extended to M+45.* TransCo modification 0016 extended this to M+25. Subsequently modification 0024 dated 3 May 1996 extended this to M+30, and was approved by Ofgas.

The points raised by the seven shippers have been addressed above. We do not intend to take this modification proposal any further forward.

In the case of both TransCo modifications (notably the scheduling charge proposal) and the Shippers' proposals there was a lack of detail and analysis supporting the case for a modification. Proposing modifications is a learning process for all parties. However, for Ofgas to process urgent modifications more quickly, focused proposals together with supporting analysis and information are vital. We have attached in the appendices a summary of our reasoning behind the views we have reached.

Please circulate this letter and the attached appendices to all interested parties.

Yours sincerely



Andrew Salmon