

Draft Modification Report
Modification Reference Number 0356

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:

This Network Code 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 recovered from all shippers across the System through the 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.

Investment for the provision of appropriate capacity has already taken place in the form of LNG assets. Additional investment 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 Shippers should bear the cost of CLNG Top-up for the following reasons:

- It was assumed at the last formula review that Transco would be allowed to recover its costs for the provision of capacity through CLNG Top-up from Users. Following Modification 0297 'Top-up Cost Treatment', Transco is now paying directly for this capacity at no charge to Users. Transco believes that the intention of modification 0297 was to challenge the need for national supply demand Top-up, indeed Transco is considering removal of references to Top-up from its safety case. There was never any intention to remove or reduce Transco's obligation in relation to the 1 in 20 and 1 in 50 security of supply criteria. An unintended consequence of modification 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 the formula review that these costs would be met by shippers.

- Had Transco provided this capacity by investing in pipelines and compressors it would have been allowed a regulatory rate of return.
- Transco has not avoided economic investment. This is demonstrated by the fact that CLNG requirements are broadly at the same level they were during the introduction of the Network Code, despite firm load growth.
- 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.

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 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 make a regulated return, and implies a perverse incentive on Transco to invest in pipe rather than to utilise existing LNG assets. Such investment would 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 modification 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 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 Shippers across the System 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.

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

This modification 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 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 shippers proportion of the costs will 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 re-establishes 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 will allow Transco to recover money provided for by the formula for the Storage year 1999/2000.
- The modification will remove undue contractual risk to Transco.
- The modification will remove what could be regarded a subsidy paid for by Transco, to the benefit of Shippers, for the provision of transmission capacity.
- Transco will receive income for the provision of transmission support, thus removing inappropriate investment signals.

Disadvantages:

- Retrospective cost exposure to Shippers for CLNG Top-up costs 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):

Not Applicable.

Transco Response:

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

As this modification relates to storage year 1999/2000, there is no interaction between this modification and compliance with safety or other legislation. This modification is merely 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 will be identified, individual Shipper proportions will be calculated and Shippers will 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 recommend this modification be implemented.

17. Text:

To follow.

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: