

Draft Modification Report
Treatment of Constrained Top-up Costs for Storage Year 2001/02
Modification Reference Number 0451
Version 1.0

This Draft 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.

In March 2000 Transco raised modification proposal 0391. This proposed that the costs of Constrained Top-up (but not National Top-up) for 2000 to 2002 should be recovered from shippers through the Top-up Neutrality mechanism. Ofgem decided to approve this cost recovery for one year only; their rationale is explained in their April 2000 decision document on their "Review of BG Transco's liquefied natural gas storage facilities".

Ofgem has stated subsequently that "LNG is an alternative to transmission capacity" which supports Transco's view that costs incurred for this purpose should be recoverable.

When the LNG and Constrained Top-up arrangements for Storage Year 2000/01 were established, Ofgem said longer term LNG arrangements would be taken forward in parallel with their review of the exit regime and interruptibles, and it was envisaged that this process would lead to revised LNG arrangements for Storage Year 2001/02. However Ofgem's proposals document for the review of the exit regime, interruptibles and LNG has not yet been published, and there is now insufficient time to implement significantly changed LNG arrangements for 2001/02.

This proposal therefore seeks to continue the cost recovery arrangements established through Modification Proposal 0391 for a further year. No Network Code modifications are necessary to allow LNG capacity to be sold in the same way as in 2000/01, although Transco would require a further derogation to again deviate from the fixed LNG prices required by Special Condition 9D of its PGT Licence.

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 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)

Representations are invited.

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 3(5) or the statement furnished by Transco under Standard Condition 3(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 Modification Proposal

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. 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) ...".

Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report

Signed for and on behalf of Transco.

Tim Davis
Manager, Network Code

Date:06/02/01