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Dear Kyran

**The Review of Top Up Arrangements in Gas. A Consultation Document. May 2004**

Thank you for the opportunity to respond to the above consultation document.

From Ofgem's description, it would appear that the key issue that has to be resolved is the difference of opinion between Transco, the HSE and Ofgem and their interpretations of top up obligations, who is responsible for meeting them and, therefore, whether Transco has an actual or only an assumed obligation in this respect. We are somewhat surprised that such a fundamental difference of opinion continues to exist, nevertheless, it is clear that only once this difference of opinion has been settled by these relevant parties will it be possible to reach a final settlement on the top up debate.

Taking a pragmatic view, and from a "GB plc" security of supply perspective, we do believe that it may be efficient for one party to have ultimate oversight of security of supply in the event of market "failure". This has been the case over recent years and no evidence has been presented to suggest that the existence of this "insurance" has reduced either a shipper's incentive to balance its portfolio or a supplier's incentive to meet its customers' demand in accordance with its obligations.

In adopting the above view, therefore, and to the extent that Transco is exposed to a real, net cost in securing top up arrangements it would seem only reasonable to allow Transco to recover these costs. For the avoidance of doubt, however, if this is to be pursued Transco must be able to demonstrate that the costs have been efficiently incurred and that they are in accordance with the economic and efficient operation of the system. Accordingly, it would be necessary to ensure that Transco is adequately incentivised to minimise any cost it incurs in providing top up and that the incentive does not "skew" any other Transco incentive. Obviously, if Transco is to be able to recover net costs from the market it will be important to ensure that the way in which this is achieved is equitable and, as far as possible, does not add to the uncertainty of transportation charges or create any market distortion. Therefore, further consideration would need to be given to the way in which the cost is allocated across market participants.

If Transco is to continue to provide top up, it is essential that the assumptions it uses to calculate the top up requirement is transparent, appropriate and accurate. Unfortunately, we do not have access to all of the information that Transco is privy to in making this calculation and it is therefore extremely difficult for us to dispute or otherwise any top up monitor level that Transco may pronounce. We are conscious, however, that the projected top up monitor level for the coming winter is considerably higher than previously experienced and we therefore take comfort that Ofgem has requested more information on Transco's supply/demand forecast methodology. We are also somewhat surprised by Ofgem's report that Transco's demand forecast is based on an un-diversified demand and that no account has been taken of storage recycling. We therefore believe that more work is required to understand exactly how Transco has derived and justified its proposed top up monitor level for the coming winter.

In order to further this debate, we believe that it would have been helpful if we had been provided with some analysis of the impact and cost to Transco of top up over recent years. For example, Ofgem is concerned about the calculation of the Top Up Market Offer Price (TMOP) and the possible impact it could have on cashout and a shipper's incentive to balance. Therefore it would have been helpful to have had some analysis that showed the TMOP over relevant periods, how this compared to cashout and the frequency that the TMOP has set cashout (bearing in mind that as far as we are aware, top up only sets SMP buy if Transco as SO purchases top up in the OCM). Similarly, it would have been helpful if Transco had presented information on the net cost to it of providing top up in recent years and its forecast top up net cost for the coming winter.

Finally, Ofgem has sought views on the publication to the market of inventory levels held in different types of storage facility. We have had discussions on this issue over the past year and, as Ofgem is aware, we are not averse to the principle of releasing such information. However, as Ofgem has recognised, there are a number of issues relating to commercial sensitivities that will need to be resolved.

I hope that our comments will be useful. Please give me a call if you would like to discuss any of the points we have raised in more detail.

Yours sincerely

Rob McDonald  
**Director of Regulation**