

TRANSCO PRICING DISCUSSION PAPER PD1

Balance of Transportation Charges

1. INTRODUCTION

Transco has published two sets of indicative transportation charges, one on the basis of no rebalancing and no restructuring of charges and the other on the basis of rebalancing to reflect the latest data on costs, and with restructured charges in line with the changes described in the consultation papers PC23 to PC32 and the discussion paper PD2.

This discussion paper:

- explains why the balance of transportation charges could change;
- provides an view of the rebalanced pricing tier changes with Transco's present intentions and a revised impact analysis on this basis;
- shows the impact of each of the possible structural changes on the changes for typical loads.

2. BALANCE OF CHARGES

2.1 Cost Pools

Transco's charges are set to reflect the balance of ongoing costs. Transco's historical ABC cost base is the main source of cost information. However a number of adjustments are made to the information provided by the historical costs to give the balance of ongoing costs:

- Restructuring and decontamination costs are excluded since these do not relate to particular transportation services;
- The cost base covers revenue costs and depreciation. Transco's allowed revenue has been set so as to allow a return on investment in assets. The pricing pools for the main charges are obtained by considering the ongoing costs and then spreading the remainder of the allowed revenue between the pools in proportion to assets.
- Where ongoing costs are known to be different from the 1997 historical costs they are used instead.

- This year options for separate charging of meter work are being put forward. In order to enable this, a separate (fourth) cost pool covering metering has effectively been established.
- A major change this year is the move to a cost base based on the regulatory value of Transco's assets, as determined by the MMC, and depreciation based on these asset values.

The balance of ongoing costs is as shown below:

Table 1: Pricing Cost Pools (£m)

	<u>NTS</u>	<u>LDZ</u>	<u>Customer</u>	<u>Non-Meter</u>	
				<u>Meter</u>	<u>Total</u>
1997 ABC Costs [1]	264	806	437	295	
Opening Margins [2]	-13				
Non-Daily Metering [3]			-61		
Meter Work [4]			28	-28	-28
Shipper Service [5]	63	26	42		
UAG		68	12		
Asset-Related	173	694	188	99	
Total	488	1,594	646	338	3,065
98/99 (%)	15.9%	52.0%	21.1%	11.0%	100%
97/98 (%)	16.0%	52.9%	<-- 31.1% -->		100%

Notes:

- [1] ABC costs shown exclude restructuring and decontamination costs, and Shipper Service and UAG costs which are added later.
- [2] Operating Margins adjustment shown is to deduct cost of storage booking in 1997 of £33m and add estimated cost of booking in 1998 of £20.
- [3] The ABC costs relating to Meter Reading have been adjusted so that only the estimated costs relating to data management are reflected in the level of the customer charge. The adjustment shown for Non-Daily Metering costs for 1997 calendar year is different from the level of NDM costs reported for Formula Year 1997/98.

- [4] Meter work adjustments - see section below.
- [5] The allocation of Shipper Service costs is in line with the phasing option for reflecting these costs put forward in consultation paper PC26.

2.2 Meter Work Cost Pool

Meter costs have this year been considered as a separate cost pool. Some of the ABC costs under the Meter Work heading relate to Dataloggers, which are charged for separately. Some costs are for Meter Work related to the relaying of Services. These costs together total £28m and have been transferred from the Meter Work pool to the remaining Customer pool.

In addition, some (£28m) of the 1997 meter costs are considered to be non-ongoing, for example terminal depreciation of meters, and so are deducted in determining the ongoing meter costs.

For meter work the charging options put forward have been based on a 7% return on assets. Further details are provided in pricing consultation paper PC25.

2.3 Comparison with 1997/8 Breakdown

The cost pool breakdown shown above is different from the breakdown used to determine the rebalanced Indicative Charges (Case B) due to refinement of the cost analysis since the Indicative Charges were published. The main refinement has been the inclusion in the analysis of ongoing Meter Work costs as a separate cost pool. The effect of this has been to reduce the Customer cost pool slightly from that used for the Indicative Charges.

As can be seen from Table 1 above, the balance of the cost pools is close to that used for the present charges. However there have been some significant changes in the costs involved.

The move to a Regulatory Value for the asset base has had a varying effect on the depreciation and asset-related revenue allocation. The abatement of the Asset Values to move from a CCA basis to a Regulatory Value basis was applied by reducing the pre-1992 assets to 60% of their previous asset value. This is in line with the MMC recommendation. A higher proportion of the NTS and LDZ assets are pre-1992 than for the Customer (Service and Meter) assets and so the abatement has had a greater effect in reducing NTS and LDZ assets values and depreciation than for Customer assets and depreciation. This is the main effect increasing the customer cost pool proportion, compared to last year's analysis.

3. PRICING TIER CHANGES

The change in the average level of the charges in line with the revised cost pool analysis shown in Table 1 is shown below.

Table 2: Pricing Tier Changes

NTS Charges	-6.8%
of which NTS capacity	+6.9%
of which NTS commodity	-32.7%
LDZ Charges	+1.3%
Customer Charges	+8.2%
AVERAGE	+2.0%

The forecast increases in LDZ and NTS load, together with the 2% increase in average charge, lead to a 5% increase in the target transportation revenue for 1998/99 to £3065m, compared to the target for 1997/98.

Although the NTS proportion of revenue is almost unchanged from last year, forecast NTS peak and annual throughput for 1998/99 has increased by 12% and 11% respectively from last year's (MMC) forecast for 1997/98. The net result is that, assuming charges are rebalanced, average NTS charges would reduce by 6.8%, but the capacity and commodity charges would change differentially due to the proposed move to a 75/25 capacity/commodity split.

Although annual LDZ throughput for 1998/99 is forecast to increase by 8% compared to the forecasts used for 1997/98, the increase is forecast to be mainly in the larger firm load and interruptible load sectors, reflecting experience in 1997/98. The forecast revenue from applying the present LDZ charges for 1998/99 would increase by only 2% compared to 1997/98. The reduction in the LDZ proportion of the cost pool means that LDZ charges would need to increase by 1.3% on average.

For Customer charges, the increase in revenue from applying the present charges to the 1998/99 forecasts is less than 1% compared to 1997/88. The Customer proportion of the cost pool, including Meter Work and the remaining Customer costs, has increased. This, together with the overall 5% increase in the size of the cost pool, means that Customer charges, with rebalancing, would need to increase by 8.2% on average. However there are large variations around this average due to the proposed changed Customer Portfolio Management cost reflectivity and differential prepayment meter charge.

4. IMPACT ON TYPICAL CUSTOMERS

The impact of the rebalanced charges, restructured in line with the methodology changes detailed in the consultation papers, is shown in Table 3 (this table is calculated on the same basis as the Indicative Charges Table 5B). As can be seen the possible changes are slightly lower in most cases than with the rebalanced indicative charges.

It should be noted that the detail of the possible phasing in of the restructuring changes in some of the consultation papers, for example the possible NTS entry and exit charge rebalancing in paper PD2, is based on the level of cost pool rebalancing shown in the Indicative Charges.

5. ANALYSIS OF IMPACT BY PRICING CHANGE

Table 4 shows a breakdown of the total impact of the rebalanced and restructured charges by cause.

For the domestic loads the possible changes having the largest impact are the rebalancing of the cost pools and the introduction of an additional charge for ETM meters. If the customer fixed charge is kept at £10 as at present then all domestic customers with a standard meter (as assumed in the analysis) would see a 2% increase.

For small commercial loads the main factor leading to the larger than average increases is the possible move to differential recovery of the Shipper Service CPM costs between domestic loads and commercial supply points.

Larger commercial and industrial loads benefit from the possible cost pool rebalancing and move to a 75/25 NTS capacity/commodity split.

QUESTION FOR DISCUSSION

Transco would welcome respondents' views on the degree of rebalancing of the main tier charges which should be implemented for October 1998.