

## TRANSCO CONSULTATION REPORT ON PC75

### NTS TO Commodity Charge

#### 1. Transco's Initial Proposal

PC75 sought views on a proposed change to the transportation charging methodology in which an NTS TO commodity charge would be created. If the TO revenue obtained from other charges was in line with target levels then it would be expected that the NTS TO commodity charge would be zero. If the TO revenue was out of line with the target level, due to entry auction revenue levels or other factors, then the NTS TO commodity charge could be adjusted downwards (so as to be negative) or upwards so as to aim to not over-recover against the maximum allowable TO revenue. This methodology could either supersede or complement that established by PC65 – sometimes referred to as a buy-back fund.

This report sets out the views received and Transco's response and final proposal.

#### 2. Summary

There were sixteen responses to the consultation paper.

Shippers & Suppliers	
AEP Energy Services	AEP
Agip	AGP
BG Gas Services	BGGS
British Gas Trading	BGT
Conoco	CON
Dynegy	DYN
ExxonMobil	EXM
Innogy	INN
PowerGen	PG
Scottish Power	SP
Scottish & Southern Energy	SSE
Shell Gas Direct	SGD
Statoil	STA
Other Interested Parties	
Association of Electricity Producers	AssEP
Corus	COR
Terra Nitrogen	TN

Four respondents supported the proposal, with some concerns (BGT COR EXM PG). Eleven respondents (AEP AssEP AGP BGGGS CON INN SP SSE SGD STA TN) did not support the proposal and one (DYN) did not say whether or not it supported the proposal.

## **1. Detailed Responses**

### **3.1 Stability of Charges**

Eleven respondents (AEP AssEP BGGGS CON DYN INN PG SP SSE SGD STA) were concerned that introducing a TO commodity charge would lead to more adjustments in the level of charges and an increased level of uncertainty for shippers and suppliers. It was suggested that this would lead to increased charges to end consumers. One respondent (STA) objected to the piecemeal changes to charges.

#### **Transco's Response**

Under the terms of its Gas Transporters Licence, Transco must set charges with a view to collecting no more than allowed by the relevant price control formula. Notwithstanding the methodology for dealing with potential over-recoveries arising from entry capacity auctions, as established by PC65 and amended in PC67, Transco is required to adjust transportation charges so as to aim not to over-recover. The introduction of a TO commodity charge would not, therefore, affect the average level of transportation charges, which is restricted by the Licence. It would, however, change the means of adjusting the level of charges and hence the distribution of charges to some extent.

Transco is not clear why implementation of the proposal would be expected to lead to more uncertainty for shippers and suppliers. The need for a change in the level of TO administered charges is expected to arise primarily from the outcome of entry capacity auctions, and this proposal is about how, rather than whether, to make such a change. Transco understands the desire of respondents to face stable transportation charges and for changes to be made infrequently and following as much notice as possible. However, this is inconsistent with Transco's Licence obligation to endeavour to set charges such that collected revenue does not exceed that allowed by the relevant price control formula. Given uncertainty regarding auction based revenues, and the outcome of incentive schemes, Transco may be obliged to change the level of transportation charges in order to be compliant with the Licence.

Transco recognises that many respondents consider that the structure and level of charges has been particularly uncertain this year. Transco would wish to emphasise that, while further change cannot be ruled out, the only adjustment to NTS transportation charges in the present formula year was the rebalancing between SO (commodity) and TO (exit capacity) charges which followed publication of Ofgem's proposed modifications to Transco's Licence. However, in light of the concerns raised, Transco proposes that the TO commodity charge should not be implemented before 1 April 2003. The indicative level of the TO commodity charge from that time, on the assumption in particular that the revenue from entry capacity auctions is in line with target levels, is zero.

### **3.2 Capacity versus Commodity adjustment**

Four respondents (INN SP SGD TN) commented that they would prefer a capacity adjustment rather than a commodity adjustment - in some cases at entry, in others at exit. It was also suggested by INN that an entry commodity charge would be more appropriate.

#### **Transco's Response**

If the proposed TO commodity charge were not introduced, in order to comply with the Licence obligation not to recover more revenue than allowed by the price control formula, Transco would be obliged to reduce NTS exit capacity charges in response to high revenue from other sources – such as entry capacity auctions. A drawback of such reductions to exit capacity charges would be that the adjustment would impact solely on firm transportation charges and hence would reduce the differential between firm and interruptible transportation charges. This would appear to be potentially inconsistent with the Licence obligation to develop a transportation charging methodology which reflects the costs incurred by the Licensee.

A drawback of an adjustment through any form of rebate related to entry capacity holdings is that this may tend to undermine the valuation of entry capacity in auctions – which may be considered to be inconsistent with Transco's Licence obligation to avoid undue discrimination. Adjustment mechanisms of this nature were considered, but deemed inappropriate, in Transco's report on PC60 (July 2000).

With regard to the structure of the TO commodity charge, Transco's proposal is that any NTS TO commodity charge should have an identical structure at all times to the NTS SO commodity charge. From October 2003 the proposed TO commodity charge would therefore apply to both entry and exit flows, in line with the planned structure of the SO commodity charge, as set out in Transco's report on PC73. The identical structure would enable the present billing arrangements to continue, with a billed NTS commodity charge equal to the sum of the TO and SO commodity charges, so as to minimise the cost of implementing a TO commodity charge for both shippers and Transco.

### **3.3 Retention of PC65 Methodology**

Four respondents (AssEP SSE SGD STA) supported retention of the PC65 methodology in addition to the introduction of the proposed TO commodity charge. However one respondent (COR) stated that this was a more complex solution.

#### **Transco's Response**

Transco considers that the retention of the PC65 methodology (as modified by PC67), along with a TO commodity charge, enables a greater level of excess auction recovery to be handled prior to an adjustment to the level of NTS exit capacity charges. The retention of the PC65 methodology also enables some levels of excess auction revenue to be handled purely through what is sometimes referred to as the buy-back fund approach, which provides the benefit of potentially offsetting shippers' exposure to capacity buy-back costs. This may be regarded as consistent with stable transportation charges.

Transco supports the view of the majority of respondents that addressed this issue and considers that the advantages outweigh the benefit of simplicity which elimination of the

PC65 methodology would provide. Transco therefore proposes to retain the existing methodology alongside introduction of the TO commodity charge.

In the PC75 consultation paper, it was suggested that if the PC65 mechanism were to be retained then it may be desirable to change the charge driver to reflect any Network Code change to the capacity buy-back cost apportionment driver, so as to retain equivalence of allocated buy-back costs and entry charge adjustments. In light of the proposal to retain the existing mechanism, as first introduced by PC65, Transco also proposes that the charge driver for the allocation of credits should be defined so as to be consistent with the capacity driver for apportioning buy-back costs, as defined within the Network Code. Transco does not regard this as a change of the transportation charging methodology since this will ensure continuation of the principle which underpinned the introduction of the PC65 methodology, which was described as being related to buy-back liabilities. Since this is regarded as a change to the operation of the methodology rather than the methodology itself, Transco proposes that this approach should be effective immediately, such that the change in capacity buy-back driver in the Network Code which is due to be implemented with effect from 1 October 2002 will be reflected in a change to the way in which reductions in entry charges are calculated with effect from the same date.

### **3.4 Minimum NTS TO Commodity Rate**

One respondent (BGT) supported the proposal that the NTS TO commodity rate combined with the NTS SO commodity rate should not be lower than the short-run marginal cost of operating the NTS system. BGT also commented that any further over-recovery not redistributed by the PC65 mechanism or by a reduction in the TO commodity charge should be handled through a reduction in the level of exit charges.

#### **Transco's Response**

Transco welcomes the support for limiting the combined level of the NTS TO and SO commodity charge to a measure of short run marginal cost. Transco believes this is consistent with the relevant objective of developing a transportation charging methodology which reflects the costs incurred by the Licensee, and is also consistent with its wider obligations to avoid undue discrimination.

Transco must endeavour to set transportation charges with a view to collecting revenue no greater than the maximum permitted by the relevant price control formula. If the proposed introduction of an NTS TO commodity charge is implemented, adjustment of NTS exit capacity charges as outlined by BGT may still be necessary in order to ensure Licence compliance. For the avoidance of doubt, Transco's proposal is that, where auction revenues indicate over-recovery would be likely if other charges were not reduced, the order of adjustments would be:

1. Do nothing – if auction revenue is within 10% of the target, there will be no automatic adjustment to charge levels;
2. PC65 mechanism (buy-back fund) - entry charge reductions consistent with monthly buy-back liabilities;
3. TO Commodity Charge adjustment – if excess auction revenue is greater than the buy-back cost target set by Ofgem for a particular year, a negative TO commodity charge

will be set. The level will be based on Transco's view of the adjustment necessary to be consistent with its obligation to avoid over-recovery in any given formula year. This assessment will take account of all the available information, including anticipated revenue from yet to be held auctions – such as daily and rolling monthly entry capacity auctions - as well as anticipated revenue based on already completed auctions;

4. Exit charge adjustment – where the combined TO and SO commodity charge is equal to short run marginal cost, Transco will reduce exit capacity charges if it believes this is necessary to maintain compliance with its Licence obligations. The short run cost related minimum commodity rate is 0.0022p/kWh, as established by Transco's report on PC60 (July 2000).

In addition, Transco may propose a positive TO commodity charge if it is clear that auction derived revenue is likely to lead to collected revenue falling short of the maximum allowed revenue calculated in accordance with the relevant price control formula.

#### **4. Conclusion**

Transco welcomes the comments received in response to the proposals contained within PC75.

Transco's final proposal is conditional on its Licence being modified in line with the proposals set out by Ofgem in September 2001. This provides for the existing price control formula in Transco's Licence to be replaced by separate formulae for the LDZs, NTS TO and NTS SO. Assuming that change is implemented, Transco proposes that an NTS TO commodity charge should be introduced but that the existing PC65/PC67 methodology should be retained as the initial means of handling excess entry auction revenue when appropriate, i.e. where auction revenue is greater than 10% above the target level. For billing purposes, until further notice a single NTS commodity charge would be retained, equal to the sum of the NTS TO and SO commodity charges. This would be expected to minimise the cost of implementation for both shippers and Transco. For Licence and accounting purposes, however, the revenue attributable to each commodity charge (whether positive or negative) would be established on the basis of the applicable rates.

Transco therefore proposes:

- **That the existing PC65/PC67 (buy-back fund) methodology be retained;**
- **That an NTS TO commodity charge be introduced from 1 April 2003;**
- **That the level of the NTS TO commodity charge, after allowing for the impact of the PC65/67 methodology, should be zero if forecast TO revenue is in line with target revenue levels. On this basis, the indicative level of the TO commodity charge from 1 April 2003, notably on the assumption that revenue based on the outcome of entry capacity auctions will be in line with target levels, is zero;**
- **That Transco should set the level of the NTS TO commodity charge to reflect the forecast level of TO revenue relative to the maximum allowed under Transco's NTS TO price control formula; and**

- **That the NTS TO commodity charge should have an identical structure at all times to the NTS SO commodity charge and that the minimum (negative) NTS TO commodity charge should be such that, in combination with the NTS SO commodity rate, the combined effective NTS commodity rate (including both entry and exit based charges) should not be lower than 0.0022p/kWh.**