

August 2001

TRANSCO CONSULTATION REPORT ON PC66

Transportation Charge Adjustments Following Entry Capacity Auctions

1. Transco's Initial Proposal

In PC66 Transco sought views on a proposal to amend its Transportation Charging Methodology such that:

Any shortfall of revenue implied by the forthcoming entry capacity auctions leads to a general increase in transportation charges rather than an increase focussed solely on the NTS Commodity Charge.

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

2. Summary

There were 13 responses to the consultation paper. One respondent wished their response to remain confidential. In the text they are referred to as UR – unattributed respondent. The other respondents were:

Shippers & Suppliers	
Amerada Hess	AMH
BP Gas Marketing	BPG
British Gas Trading	BGT
Conoco	CON
Exxon Mobil Gas Marketing	MOB
Northern Electric	NE
Powergen	PG
Scottish & Southern Energy	SSE
Shell Gas Direct	SGD
Total Fina Elf	TOT
Other Interested Parties	
Association of Electricity Producers	AEP
Corus	COR

- Five respondents supported the proposal (BPG CON NE TOT COR).
- Eight respondents (AEP AMH BGT MOB PG SSE SGD UR) did not support the proposed change.

3. Detailed Responses

3.1 Timing Issues

A number of respondents (AEP BPG COR PG SSE UR) expressed dissatisfaction with the shortened consultation period believing that it did not provide sufficient opportunity for the community to fully consider the proposals. Two expressed the opinion that hastily made changes to the regime had a greater potential for undesirable consequences.

Two respondents expressed the opinion that it was too close to the opening of the next set of MSEC auctions to be making major changes to existing methodologies (AEP SSE). One of these (AEP) also stated that the proposal would result in the community having only two weeks to implement changes to all transportation charges, rather than the NTS commodity charge alone.

Three respondents (AMH PG SSE) stated that many October gas contracts had already been agreed between shippers and their customers, and that it was therefore unreasonable to expect the community to implement a general adjustment to transportation charges at such short notice.

One respondent (SSE) wished to know whether Transco had gained prior approval from Ofgem to have Licence condition 4.2(a), that requires a consultation period of 28 days, waived prior to publication of PC66.

Transco's Response

Transco recognises that a short consultation period is not an ideal situation, but believed it appropriate to raise the issue in light of implementation of Network Code Modification Proposal 0488.

Transco understands the difficulties which a change in the general level of charges may cause for those that have already signed forward contracts but believes that price changes along the supply chain are an accepted element within the calculation of business risk. Any increase in the general level of charges would occur only following under-recovery in the auctions.

Prior to the publication of PC66 Transco did receive from Ofgem a derogation of the usual 28 day consultation period.

3.2 Comparison with PC60 mechanism

A number of respondents (TOT BGT SGD AMH SSE UR) compared the proposal with the principles and practice of the present mechanism as set out in PC60. Four of these (TOT BGT SGD SSE) were of the view that adjustments to the generality of charges in response to deviations from target revenue, implied by entry capacity auction outcomes, would have undesirable distributional outcomes between shippers and various consumer groups. For this reason it was believed that, as far as possible, adjustments should be ring fenced within the NTS tier of transportation charges.

Two respondents (SSE UR) thought that a major flaw in the proposal was that it created an asymmetric mechanism, dealing with under and over recovery differently. The latter expressed the view that this asymmetry increased the level of market distortion caused by any adjustment mechanism, and that it meant that there was no longer a balance of risk between a situation of under and over recovery on any particular shipper. However, one respondent (CON) suggested that the proposed mechanism did create symmetry following the general 15% reduction in transportation charges.

Two respondents (AMH SSE) were unhappy that the proposal to abandon the concept of a dead-band, as established by PC60, within which deviations from target revenue would not result in any countervailing adjustments.

Transco's Response

Transco recognises the arguments in favour of ring fencing any post auction adjustments within NTS charges. However, in the event of an auction shortfall, this could be regarded as arguing for a reversal of the general reduction in charges following the last set of capacity auctions – and Transco agrees with the respondent that considered this appropriate symmetry.

Transco's proposal assumed that the dead-band established by PC60 should be disregarded since Transco's obligation to set charges consistent with its price control would remain and, in the interests of price stability, Transco believed it would be appropriate to consider the level of charges in this wider context.

3.3 Other Issues

Two respondents (COR MOB) expressed the opinion that having an auction regime within the context of a regulated income was fundamentally flawed. Two respondents (COR CON) were of the opinion that the regime was being developed on an ad hoc basis, that this was unsatisfactory and that something needed to be done. Another two respondents (BPG NE), although in support of the proposal, saw it merely as an interim measure prior to the introduction of a mechanism that provided more appropriate long-term signals to Transco.

Three respondents (BPG SSE PG) stated that the fact that a decision had not yet been made on the proposals contained within PC65 meant that it was more difficult to fully assess the proposals in PC66.

Three respondents (AMH PG SSE) expressed the view that the increasing frequency of changes to Transco's charges was making effective competition between shippers more difficult.

Transco's Response

Transco understands the concerns about the present arrangements surrounding entry capacity auctions and the difficulty of reconciling auction-based charges with price control based revenue restrictions. While these issues may be resolved in the context of proposals for the entry capacity regime post April 2002, Transco believes it is appropriate to consider whether short term changes should be made in the present circumstances.

Transco does not believe that the outcome of PC65 has a bearing on the fundamental issues surrounding this pricing proposal.

4. Conclusion

Despite the constraint of a limited consultation period, Transco welcomes the constructive and full comments received.

The issues raised concerning the interaction between Transco's price control and entry capacity auctions relate to Transco's PGT Licence obligation to set charges with a view to not exceeding the level of allowed revenue in any formula year – 1 April to 31 March. Transco therefore believes it is appropriate to consider the impact of auction-based charges in the same timescale, and hence that any shortfall in the forthcoming auctions should first be applied to reversing the effects of changes to charges following the last set of NTS auctions.

With effect therefore from 1 October 2001, Transco proposes that the Transportation Charging Methodology be amended such that:

- Any shortfall of revenue implied by auction outcomes leads to a general increase in transportation charges rather than an increase focussed solely on the NTS Commodity Charge.