Pricing Consultation Paper PC70

NTS System Operation Transportation Charges

SUMMARY

Ofgem has proposed that from April 2002 the National Transmission System (NTS) and Local Distribution Zones (LDZs) should be treated separately with a further division between the NTS Transmission Asset Owner (TO) and NTS System Operator (SO). Transco has accepted final proposals for the TO component of the new price control, with the SO component presently the subject of Ofgem consultation.

Transco proposes to amend its Transportation Charging Methodology to reflect the proposed new regulatory framework and other developments. On the assumption that, from April 2002, Transco is to operate under NTS SO incentives schemes along the lines proposed by Ofgem, this paper proposes a number of changes to the methodology that relate to the NTS commodity charge, such that:

- the NTS standard commodity charge be replaced by a SO commodity charge;
- the SO commodity charge be based upon the target SO revenue level (whereas the NTS standard commodity charge was based on 35% of target NTS revenue);
- the SO commodity charge should apply to all gas transported through the NTS, irrespective of the type of end load. A particular change is that the charge would be payable on all gas transported to storage sites.

1. Introduction

Ofgem has proposed that from April 2002 the National Transmission System (NTS) and Local Distribution Zones (LDZs) should be treated separately with a further division between the NTS Transmission Asset Owner (TO) and System Operator (SO).

In its 'System Operator incentives 2002-7, Initial proposals'[1] document, Ofgem has proposed that Transco's SO should be subject to a new series of incentive arrangements whereby in large part SO Allowed Revenue would be adjusted depending upon the level of actual cost relative to a forecast for each incentive described by Ofgem.[2] Transco would share the benefits arising from superior performance under each scheme and share in any costs arising from inferior performance subject to caps and collars where appropriate.

The proposed introduction of the separate price controls and of the new incentive schemes for the SO makes it appropriate to change the Transportation Charging Methodology.

2. SO Costs

2.1 Present Treatment of Costs

Costs relating to Residual Gas Balancing, Capacity buy-back and Operating Margins (Gas) costs are subject to neutrality processes defined in the Network Code. As such, apart from administrative costs and costs arising from incentive arrangements, the net costs in these areas are nil. The incentive credits and debits are invoiced independently of Transco's allowed revenue and, following the implementation of Modification Proposal 0488, neutrality processes.

Other NTS SO costs are incorporated, for charge setting purposes, within the NTS costs and are reflected in the level of NTS transportation charges.

2.2 Proposed Treatment of Costs

Ofgem has proposed that there should be SO incentive arrangements in relation to all of the following activities:

a) NTS entry capacity investment;
b) NTS entry capacity buy-back;
c) NTS exit capacity;

[1] September 2001, Transco's National Transmission System, System Operator incentives 2002-7, Initial proposals.
[2] An exception to this would be if Transco's current Energy Balancing incentive were continued, whereby Transco is not incentivised to minimise net cost but is incentivised to keep the marginal trade of the Market Balancing Actions it takes to within 5% of System Average Price. Ofgem has considered the extension of this type of incentive: Section 10.21 September 2001, 'Transco's National Transmission System, System Operator incentives 2002-7, Initial proposals'.

d) System balancing;[3]
e) Residual gas balancing;[4]
f) Internal costs.

Under the proposals, SO would share the benefits arising from superior performance under each incentive scheme and share in any costs arising from inferior performance, subject to caps and collars.

The details of the incentive arrangements and treatment of incentive costs and revenue which could arise has not yet been finalised. For the purposes of this consultation paper, it is assumed that the incentive costs and revenue would be borne or recovered through adjustment to the allowed level of SO revenue rather than through, say, adjustments to any neutrality mechanisms.

2.3 Continuation of Neutrality Mechanisms

The costs associated with Residual Gas Balancing, Operating Margins (gas) and Capacity buy-backs are currently handled via neutrality processes. Transco proposes to maintain the neutrality processes for handling these costs. This will minimise the extent of any system and Network Code changes for both Transco and Shippers. This is, however, dependent upon Ofgem's final proposals for SO incentives.

The remainder of this paper is written on the assumption that Ofgem's final proposals support the continued use of neutrality for handling those costs identified in this section. On this assumption the net SO costs associated with these items would be nil (apart from administrative costs and incentive payments or revenues).

2.4 Allowed SO Revenue

Given the proposed continuation of the present neutrality mechanisms, it follows that the allowed revenue that Transco will seek to recover will reflect the System Balancing costs and NTS SO internal costs plus the revenues or payments arising from the NTS SO incentive schemes.

2.5 Structure of SO Charge

The cost of NTS shrinkage is largely related to the level of throughput. The drivers underlying the level of the other costs expected to be reflected in the base level of allowed revenue - Top-up, Operating Margins capacity costs and SO internal costs - are more complex. In order to be cost-reflective whilst minimising complexity, and to avoid excessive billing costs for both Transco and Shippers, it is proposed to recover all SO allowed revenue through commodity charges – the proposed new SO commodity charge along with the existing Compression Charge, for gas delivered at the Total Oil Marine sub-terminal at St. Fergus, and the existing System Balancing

[3] Includes NTS SO Shrinkage costs and Operating Margins storage costs.
[4] Transco will be incentivised via one of two options. Option 1 is a continuation of the existing incentive scheme whereby Transco is incentivised to minimise the price and volume of the balancing actions it takes. Option 2 would incentivise Transco to minimise the net costs of system balancing, i.e. balancing costs and revenues, imbalance costs and revenues and scheduling charge revenues.

Charge, which is zero for shippers operating wholly under Network Code arrangements.

The potential incentive costs and revenues may also have drivers other than throughput, for example capacity buy-back incentive costs may be related to capacity holdings. However, these incentive costs and revenues are expected to be relatively small and there will often not be clear drivers behind them. For these reasons, and in order to avoid billing complexity and cost, it is proposed that the single commodity charge will cover these items as well.

2.6 Setting of SO Commodity Charge

The SO commodity charge will be set based upon forecast SO allowed revenue and forecast NTS throughput. Since both of these forecasts will be subject to uncertainty, the level of the charge will be adjusted from time to time as necessary to reduce the level of over- or under-recovery. The requirement for and timing of such adjustments in these circumstances will depend on the final Licence proposals.

3. Application of SO Commodity Charge

At present the NTS commodity charge is applied to all NTS throughput apart from some gas transported to gas storage sites.

There is no indication that SO costs related to gas transported to storage sites are any lower than for gas transported to other types of load. From a cost-reflectivity perspective it would therefore seem appropriate to apply the SO charge to all NTS throughput irrespective of the type of load.

In addition, the potential development of facilities encompassing storage facilities with onshore fields, other types of end user load or other connections, makes it increasingly difficult to determine whether gas is destined for storage facilities or not. By applying the SO charge to all NTS throughput, the administrative costs of distinguishing between such loads and ad-hoc billing arrangements for coping with the present charging situation could be avoided.

The indicative level of the SO commodity charge from April 2002 is 0.0092 p/kWh, substantially lower than the present standard NTS commodity charge. The economic impact for storage site users of charging a commodity charge on gas transported to storage sites will thus be reduced relative to the present charging levels.

It is therefore proposed that the SO commodity charge should be applied to all NTS throughput irrespective of the type of load supplied.

4. NTS Optional Commodity Charge

The NTS optional commodity charge was implemented to avoid giving perverse economic incentives to build dedicated pipelines bypassing the NTS, which could result in an inefficient outcome for all system users.

The justification for the optional commodity charge still applies and so it is proposed to retain it as an optional alternative charge to the SO commodity charge.

However, the justification for the optional charge relates primarily to economic incentives related to the construction of dedicated additional NTS capacity, which may be of greater relevance to the TO than to the SO.

The potential for perverse economic incentives is related in part to the standard form of the commodity charge. If the commodity charge were distance-related this would reduce this potential problem. Transco's present view is that the benefits of a standard commodity charge, in terms of cost and simplicity of application, far outweigh any benefit of a distance-related commodity charge.

Transco would welcome views on whether it is appropriate to continue with the optional commodity charge in this form, whether it should now be reconstituted in a different form or removed altogether and whether the SO commodity charge should be distance-related rather than a standard charge.

QUESTIONS FOR CONSULTATION

Transco seeks views on the following proposed changes to its Transportation Charging Methodology relating to the proposed SO incentives:

- That the NTS standard commodity charge be replaced by a SO commodity charge;
- That the SO commodity charge be based upon target SO revenue level (whereas the NTS standard commodity charge was based on 35% of target NTS revenue);
- That the SO commodity charge should apply to all gas transported through the NTS, irrespective of the type of end load. A particular change is that the charge would be payable on all gas transported to storage sites.

Transco would welcome views on whether it is appropriate to continue with the optional commodity charge in this form, whether it should now be reconstituted in a different form or removed altogether and whether the SO commodity charge should be distance-related rather than a standard charge.