December 2001

TRANSCO CONSULTATION REPORT ON PC70

NTS SYSTEM OPERATION TRANSPORTATION CHARGES

1. Transco's Initial Proposal

In PC70 Transco sought views on the following proposed changes to its Transportation Charging Methodology relating to the proposed National Transmission System, System Operator (NTS SO) form of control:

- That the NTS standard commodity charge be replaced by a SO commodity charge;
- That the SO commodity charge be based upon target SO revenue (whereas the NTS standard commodity charge was based on 35% of target NTS revenue); and
- 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 also welcomed views on whether it is appropriate to continue with the optional commodity charge in its present 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.

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

2. Summary

There were twelve responses to the consultation paper.

Shippers & Suppliers	
Amerada Hess	AMH
British Gas Trading	BGT
BP Gas Marketing	BPG
Dynegy	DYN
Innogy	INN
Powergen	PG
Scottish Power	SP
Scottish & Southern Energy	SSE
Shell Gas Direct	SGD
Statoil	STA
TXU Europe Energy Trading	TXU
Other Interested Parties	
Association of Electricity Producers	AEP

- Eleven respondents broadly supported the proposal (AMH BGT BPG INN PG SP SSE SGD STA TXU AEP).
- One respondent (DYN) did not support the proposal.

3. Detailed Responses

3.1 General Principle

Eight respondents (AMH BGT BPG INN SP SSE SGD STA) stated that they supported the principle that the existing NTS commodity charge should be replaced by a System Operator commodity charge, and that this charge be set to raise the SO revenue as derived by the SO form of control, rather than to aim to raise a given proportion of NTS target revenue. However, five respondents expressed a degree of concern that Transco's proposals might need to be revised following the publication of Ofgem's final SO proposals in December 2001 (AMH BGT PG SSE STA). Another two (TXU DYN) stated that nothing should be agreed until these final proposals were known.

Transco's Response

Transco welcomes the widespread support for the principle on which these proposals are based. Transco has taken Ofgem's final SO incentive proposals into account in its final proposals for changes to the charging methodology, but would welcome further comments from respondents in the light of Ofgem's proposals.

3.2 Scope and Volatility of Charge

Some respondents were unsure about which costs were, and which were not, included within target revenue. One (STA) wished to know the level of performance against the incentive regime assumed. Three (AMH AEP INN) wanted clarification about which costs would be funded through neutrality and which would be funded by the SO charge. Finally, one (PG) was unsure of the position with regard to primary entry capacity auction revenues.

Six respondents (INN DYN SSE AEP TXU AMH) expressed concern about either the frequency, speed, or range of variation in the level of the charge. One (DYN) thought that it might be helpful if Transco had made some estimate of the likely range over which the charge could vary.

Transco's Response

Target SO revenue will depend on the level of allowed revenue implied by the SO incentive proposals which, in due course, are incorporated in Transco's Licence, and on the extent of neutrality arrangements. The Network Code defines the extent of neutrality arrangements, and Transco published indicative charges on the basis that no Network Code Modification Proposals are in prospect which might be expected to amend the existing neutrality arrangements. Hence these costs are excluded from the SO revenue to be recovered through the commodity charge, but the level of charge would need to be reconsidered were the Network Code to be amended. The indicative SO commodity charge in PC70 was also based on an assumption of neutral performance within any incentive scheme.

Under Ofgem's final SO incentive proposals, Transco believes that most primary entry capacity auction revenue relating to capacity sold up to the baseline capacity level will be accounted for within the TO price control formula. The exception would be on the day capacity sales, which Ofgem's final proposals document suggests would be treated as buy-back incentive revenue.

Transco hopes that the SO commodity charge can be relatively stable over time, but believes there is considerable uncertainty about operation of the revised price control arrangements and the implications for price stability. The degree of change is likely to be affected by performance under the incentive regime and Transco's GT Licence requirements, as well as the scope of neutrality arrangements.

3.3 Application of Charge

Three respondents (SSE AEP INN) did not believe that the charge should be applied only on the basis of throughput at exit, as this was advantageous to traders at the NBP. Two (SSE AEP) suggested that a fair compromise would be a 50:50 split in the charge between entry and exit flows.

Five respondents (AMH SP STA PG BPG) expressed support for the proposal that the charge should apply to all gas flows including those into storage. Three (DYN TXU BGT) expressed the opposite view; indeed one (DYN) rejected the entire set of proposals on these grounds. This respondent thought that the proposal would lead to increased storage and flexibility costs and might reduce liquidity at the NBP. Another (SP) was concerned that the charge might be applied to transportation to certain storage sites only, which would be potentially discriminative and a disincentive to the development of the independent gas storage market. Two respondents (TXU DYN) questioned how the mechanism could be applied in practice since on any day it was perfectly possible to have nominations both into and out of a storage site, a shipper could therefore face large charges even though their net position was zero.

Transco's Response

Transco is not clear why charging on the basis of exit flows should lead to distortions along the gas supply chain. In a competitive gas supply market, gas prices at the NBP would be expected to take into account transportation costs incurred. While Transco accepts that charging on the basis of both entry and exit may be appropriate, but considers that the cost and complexity of charging on entry flows as well as exit flows outweigh any benefits in the short term.

Transco remains of the view that there is typically no difference in transportation costs incurred between transportation to storage exit points and transportation to other similar supply points, and so remains of the view that in principle the SO commodity charge should apply to all NTS flows, including flows to all storage sites. Since the charge would be levied on flows at exit, nominations out of storage into the NTS would not pay the charge until the gas exits the system.

However, Transco is of the view that the application of the commodity charge to all exit flows at storage exit points will require modification to the Network Code, since at present it states that exit flows to storage do not incur the NTS commodity charge unless the gas is consumed at the storage location. If this change to the charging methodology is not vetoed, Transco will seek to raise a modification to the Network Code to enable the SO commodity charge to be applied to all exit flows at storage exit points. The modification process will allow further debate on this issue prior to it being implemented.

3.4 Continuation of Optional Tariff

Six respondents (BGT PG BPG SGD AMH STA) expressed the opinion that an optional tariff should remain in order to avoid the possibility of uneconomic bypass. Two respondents (AEP INN) stated that although they thought the optional tariff should remain, this would be more appropriately dealt with via TO charges; however both recognised that this might be difficult given entry capacity auctions. For this reason the latter (AEP) was of the view that present arrangements should remain as an interim solution.

Transco's Response

Transco recognises that the continuation of the optional tariff in its present form may not be an ideal method of dealing with this issue. However, Transco is of the opinion that, at present, it is a pragmatic method of helping to avoid uneconomic bypass while recognising developments in the transportation business.

3.5 Other Issues

One respondent (AMH) asked whether the TNI discount would be applied to the SO commodity charge in the absence of the NTS commodity charge.

Transco's Response

The TNI discount will apply to the SO commodity charge.

4. Conclusion

Transco welcomes both the comments and level of support received for the proposals contained within PC70. Transco proposes that with effect from 1 April 2002 the Transportation Charging Methodology should be amended such that:

- an SO commodity charge be introduced;
- the SO commodity charge be based upon target SO revenue level;
- the SO commodity charge should apply to all gas offtaken at exit points from the NTS, subject to any restrictions imposed by the Network Code.