



09 January 1998

Direct Dial: 0171-932-1655
Our Ref. : SD/RBA/TR/A/PS 33
Your Ref. :

Tim Davis
Manager, Pricing
Transco
31 Homer Road
Solihull
West Midlands B91 3LT

Dear Tim

NTS Optional Commodity Tariff

Thank you for your letter of 12 December 1997 submitting your final proposal for an Optional NTS Commodity Tariff. I have attached a paper that explains and summarises the Director General's position on this proposal. You will see that we have decided not to veto your proposal.

I look forward to receiving your modification introducing this charge into the Network Code and discussing those detailed issues, such as how to measure distance (as the crow flies or length of pipe), that need to be clarified before the charge is implemented.

Please copy this letter and the attached paper to all parties that received your original consultation paper PC9A.

Yours sincerely

A handwritten signature in black ink, appearing to read 'SRD', written over a horizontal line.

Shaun Day
Economic Adviser
Transportation Pricing

Ofgas' view on Transco's proposal to introduce an Optional NTS Commodity Tariff as part of its charging methodology

Introduction

On 12 December 1997, Transco submitted to Ofgas its final proposal to modify its charging methodology and introduce an Optional NTS Commodity Tariff to be available as an alternative to the standard uniform NTS commodity rate. The NTS Optional Commodity Tariff would provide the potential for a discount on the existing NTS commodity tariff. The discount would increase the larger the load and the closer the load to the terminal. The form of the tariff means that it would be desirable only for shippers to loads close to terminals. As such, only these shippers would opt for this tariff.

The optional tariff will be recalculated each year in line with the prevailing SOQ of a site and Transco proposes to 'escalate' the charge each year by an RPI-X mechanism in line with the price control.

Regulatory framework

Transco is required (by amended standard condition 4 of BG Plc's public gas transporters licence) to alter the way in which it calculates its charges (the charging methodology) in order to enable it to continue to achieve its relevant objectives. In considering proposals from Transco, Ofgas must therefore consider whether the proposals meet the relevant objectives. That is:

- (a) that compliance with the methodology results in charges which reflect the costs incurred by the licensee in its transportation business;
- (b) that ... the methodology properly takes account of developments in the transportation business; and
- (c) that .. compliance with the methodology facilitates effective competition between gas shippers and between gas suppliers.

Proposals from Transco have to be consulted upon and this took place during November and December 1997. The proposals come into effect unless the Director

General has directed that the proposals should not come into effect. This note explains the Director General's decision with regard to this proposal.

In reaching a decision we are also required to take into account the Director General's duties under the Gas Act 1986 (as amended).

Views of parties

Responses were generally favourable to the concept of a reduced tariff for large loads close to terminals, although several of those responses indicated that the proposed tariff was still too high to deter bypass of Transco's system.

One response, received after the consultation closed out, was largely negative. In short, the response doubted that the proposal met Transco's relevant objectives. In short this response argued that this tariff was not cost reflective and was discriminatory. Indeed this response argued that this proposal should be rejected and instead a more fundamental review of Transco's charging structure is required.

Ofgas' response

Transco originally issued a consultation paper in February 1997 entitled "PC9: Optional NTS commodity tariff". Prior to submitting its final proposal, Transco asked Ofgas to provide an indication of its views on this issue. Ofgas indicated that it was broadly content with the concept of a short haul tariff and that it was appropriate for Transco to implement a tariff that results in lower prices to large loads situated close to terminals. However, Ofgas indicated that it was not convinced that the structure and level of the proposed tariff were appropriate and that it wished to consider the proposed tariff in the context of a wider review of Transco's charging structure.

Since that time Ofgas has undertaken work on Transco's underlying costs with a view to revising Transco's charging structure. We intend to publish the results of that work in the spring of 1998. However, Transco and some shippers indicated that investment decisions on by-pass projects were imminent and a decision on the proposed optional short-haul tariff was needed early in 1998.

Our work indicates that Transco's proposal would not constitute predatory pricing, that is the proposed tariff is above incremental cost. Ofgas notes that many respondents to Transco's second consultation also indicated that the proposed optional tariff was not predatory. Indeed many respondents indicated that, in their view, taken together with entry and exit charges, total transportation charges for large loads close to terminals would be on the high side.¹

We note Transco's comments with regard to the effect of the introduction of the NTS Optional Commodity Tariff on other users of the transportation system. We would not however expect the effects on other customers to be greater than the £16 million a year suggested in the paper. We will be asking Transco to verify this effect in its annual report to Ofgas on its charging methodology.

Transco itself recognises that the NTS Optional Commodity Tariff is only a start to addressing pricing policies that appear to give perverse economic incentives. Therefore, Ofgas expects Transco to propose extending the principle of more cost-reflective commodity charges to all users of the system in time for October 1998.

Taking all these points into account, Ofgas has decided not to veto this proposal.

¹ For a full description of predatory behaviour see Office of Fair Trading Research Paper 5, *Predatory Behaviour in UK competition policy*, November 1994.