TRANSCO PRICING DISCUSSION PAPER PD3

Balance of Transportation Charges

1. INTRODUCTION

The indicative transportation charges proposed for implementation on 1 October 1999 are based on cost pools derived from Transco's ABC cost base for the year ending December 1998. This discussion paper sets out these cost pools and compares the percentage breakdown to that used for the 1 October 1998 charges. The paper also provides a view of the rebalanced pricing tiers compared with the present structure and an analysis of the impact of the changes on the charges for typical loads.

2. BALANCE OF CHARGES

2.1 Cost Pools

Transco's charges are set so as to recover the total allowed revenue under the Price Control Formula. For charging purposes Transco's system is split into three elements: the National Transmission System (NTS), the Local Distribution Zones (LDZs) and customer related activities. For each of these elements, the charges set reflect ongoing costs plus a scaling factor, which mainly allows for return on assets, to ensure that the correct total revenue is recovered. Transco's ABC cost base, which covers revenue costs and depreciation incurred, is the source of the basic cost information, but a number of adjustments are made so that the costs used reflect ongoing costs and so that, together with the scaling factors, they sum to the target revenue. The resultant totals are known as Cost Pools. Adjustments made are:

- Restructuring and decontamination costs are excluded since these do not relate to transportation services;

- Where ongoing costs are known to be different from the 1998 actual costs they are used instead.

- The difference between the costs and the target revenue is allocated between the charging elements in proportion to the regulated asset value of each element. The share of assets is used as the basis because the main element in the adjustment is the return on assets.

This year the Customer cost pool has been divided into Meter Work, Meter Reading and Non-Meter, as this is consistent with the three business structure proposed in Ofgas's unbundling discussion document.

The derivation of the cost pools used as the basis for the proposed 1999 charges is set out below:

Table 1: 1999 Pricing Cost Pools

	NTS	LDZ	Non-Meter Customer	Meter Work	Meter Reading	Total
	£m	£m	£m	£m	£m	£m
1998 ABC Costs [1]	242	770	370	232	39	1,653
NDM Cost-Pass Through [2]					-28	-28
Mains Emergency Work		21	-21			0
Operating Margins [3]	-8					-8
Shipper Services	60	27	38			125
Unaccounted for Gas		42				42
Asset Based Adjustment [4]	190	718	194	102		1,204
Cost Pool Totals	**484**	**1,578**	**581**	**334**	**11**	**2,988**
1999 %	16.2	52.8	19.4	11.2	0.4	100
1997 % [5]	16.0	52.9		31.1		100

Notes:

[1] The ABC costs shown exclude restructuring and decontamination costs to put the costs on to an ongoing basis. Shipper Services costs and UAG costs are excluded at this stage as they are added in to the cost pools using the pricing methodology.

[2] The estimated amount allowed under NDM cost pass-through is excluded from the ABC costs as this amount is not recovered through the transportation charges.

[3] The Operating Margins adjustment shown is to deduct the cost of storage booking in 1998 of £28m and add the estimated cost of booking in 1999 of £20m.

[4] The Asset Based Adjustment allocates the difference between the total adjusted ABC costs and the total target revenue (£2988m) across the cost pools pro rata to the assets attributed to each of those cost pools, with the exception of meter work where the adjustment is equal to 7% return on assets.

[5] The October 1998 charges were not rebalanced and so reflect the same balance of costs used to determine the October 1997 charges.

2.2 Comparison with 1998/9 Breakdown

The cost pool breakdown shown in Table 1 above is very similar to that used for the October 1998 charges. The main change is that the components of the Customer charge are now visible.

3. PRICING TIER CHANGES

The balance between the three main sets of charges, NTS, LDZ and Customer, was not changed at October 1998 following consultation on rebalancing. Charges were thus last set so as reflect the balance of costs at October 1997. The proposed changes in the balance of charges reflect two types of change since October 1997:

- changes to the balance of cost pools (discussed in Section 2.)
- changes caused by differential volume growth between the NTS and LDZ.

Table 2 below shows how the charges set in October 1997 to reflect a particular cost split (Column A) would, if simply scaled by a common factor and using present forecasts for 1999/2000, recover charges on a different percentage breakdown (Column B). This change is caused by the large growth in throughput for NTS loads, including the interconnectors, so that NTS throughput as a whole (which includes LDZ throughput) has seen a higher percentage increase than LDZ throughput or LDZ customer numbers.

The present balance of costs (Column C) has not changed greatly from that used in 1997. However, in order to reflect this balance the charges would need to be changed by the percentages shown in Column D if there were no change in the average level of charges. When these changes are combined with the indicative 3.5% average reduction in charges then the resulting changes in the average charges in each area are as shown in Column E.

Table 2: Changes in Balance of Charges

	A **Oct 97 Split**	**B** **Same charges now**	**C** **Cost Pools**	**D** **% Change col C/col B**	**E** **Proposed Changes**
NTS	16.0%	17.7%	16.2%	-8.5%	-11.7%
LDZ	52.9%	52.4%	52.8%	+0.8%	-2.7%
Customer	31.1%	30.0%	31.0%	+3.3%	-0.3%
AVERAGE				**0%**	**-3.5%**

4. CHANGES WITHIN EACH CHARGE AREA

There are variations around the average in the change in the NTS, LDZ and Customer charges which would apply to any particular supply point due to the methodology proposals in each area. These include:

4.1 NTS Charges

In a similar way to which the balance of the main charges has changed, so the forecast balance of the capacity and commodity charge revenue has, using forecasts for 1999/2000, changed from 65/35 to 64/36 due to the expected higher growth in throughput than in booked capacity. In order to retain a 65/35 split, the indicative capacity charges are based on a 10.3% average reduction whereas the indicative standard NTS commodity charge is based on a 14.1% reduction.

The indicated rebalancing of entry and exit capacity charges will lead to variations around the average 10.3% NTS capacity charge reduction depending upon location.

4.2 LDZ Charges

The proposed rebalancing of the LDZ charging functions will lead to differences in the level of change in the LDZ charges depending upon load size.

4.3 Customer Charges

The proposed changes to the methodology of reflecting the Shipper Service CPM costs will lead to the customer charges for larger customer increasing by a small percentage whereas those for domestic supply points will decrease by more than the average (-0.6%).

Since no change to the £10 fixed element of the customer charge has been proposed the commodity element of the charge will be reduced by 0.9% to give the average 0.6% reduction.

5. ANALYSIS OF IMPACT BY PRICING CHANGE

The impact of the rebalanced charges, restructured in line with the methodology changes detailed in the consultation papers, is shown in Table 3.

Table 4 shows a breakdown of the total impact of the rebalanced and restructured charges by cause. The largest reductions, on a p/th basis, are for domestic loads, where the proposed rebalancing of LDZ charges will lead to larger reductions than average.

Firm industrial and commercial loads within the LDZs will typically have smaller than average percentage reductions due to the effect of the proposed LDZ charge rebalancing. This same effect will also lead to small increases in charges for interruptible loads within the LDZ.

Loads connected to the NTS will have the largest percentage reductions in transportation charges, although in p/th terms these reductions are smaller than the proposed reductions for domestic loads. These large percentage reductions are related primarily to the reductions in the NTS charges, which are linked to the throughput growth on the NTS.

QUESTION FOR DISCUSSION

Transco would welcome respondents' views on the degree of rebalancing of the main tier charges which should be implemented for October 1999.

TABLE 3: IMPACT OF NEW PRICES FOR TYPICAL CUSTOMERS: AVERAGE CHANGE = -3.5%

		Annual Consumption therms	Present Charge p/th	October 99 Charge p/th	Change p/th	Change %
Small domestic load		300	19.3	18.6	-0.7	-3.6%
Typical domestic load		650	17.5	16.8	-0.7	-4.0%
Large domestic load		1,000	17.0	16.3	-0.7	-4.1%
LDZ	Firm industrial and	5,000	12.2	12.0	-0.2	-1.9%
	commercial loads	20,000	8.7	8.5	-0.2	-2.0%
		50,000	7.9	7.7	-0.1	-1.7%
		100,000	6.8	6.7	-0.1	-1.5%
		200,000	6.3	6.2	-0.1	-1.2%
		1,000,000	4.9	4.8	-0.0	-0.3%
		5,000,000	3.9	3.9	0.0	0.8%
LDZ	Interruptible loads	500,000	3.0	3.0	0.1	2.2%
		2,000,000	2.3	2.4	0.1	2.2%
		10,000,000	1.8	1.9	0.1	3.6%
NTS	Firm loads	200,000,000	1.0	0.9	-0.1	-12.3%
NTS	Interruptible loads	200,000,000	0.6	0.5	-0.1	-14.1%

Note

Domestic charges assume standard meter.

Both present and indicative charges exclude any non-daily meter reading charges.

The charges assume average NTS entry and exit charges.

The load factors assumed are typical of those determined by the EUC algorithms.

INDICATIVE TRANSPORTATION CHARGES FOR OCTOBER 1999

TABLE 4: IMPACT OF EACH CHANGE IN DERIVATION OF CHARGES

		Annual Consumption therms	Current Charges p/th	3.5% decrease to all charges		Rebalance ABC split		Rebalance LDZ Charges		New CPM & D'logger charges		Re
				change	New charge	change	New charge	change	New charge	change	New charge	cl
Small domestic load		300	19.3	-3.5%	18.6	0.9%	18.8	-0.9%	18.6	-0.1%	18.6	
Typical domestic load		650	17.5	-3.5%	16.9	0.6%	17.0	-1.0%	16.8	-0.1%	16.8	
Large domestic load		1,000	17.0	-3.5%	16.4	0.5%	16.5	-1.0%	16.3	-0.1%	16.3	
LDZ	Firm industrial and commercial loads	5,000	12.2	-3.5%	11.8	-0.2%	11.8	1.0%	11.9	0.7%	12.0	
		20,000	8.7	-3.5%	8.4	-0.7%	8.3	1.8%	8.5	0.3%	8.5	
		50,000	7.9	-3.5%	7.6	-1.0%	7.5	2.5%	7.7	0.3%	7.7	
		100,000	6.8	-3.5%	6.6	-1.2%	6.5	3.0%	6.7	0.3%	6.7	
		200,000	6.3	-3.5%	6.0	-1.4%	5.9	3.5%	6.2	0.2%	6.2	
		1,000,000	4.9	-3.5%	4.7	-1.9%	4.6	4.9%	4.8	0.2%	4.8	
		5,000,000	3.9	-3.5%	3.7	-2.4%	3.6	6.6%	3.9	0.1%	3.9	
LDZ	Interruptible loads	500,000	3.0	-3.5%	2.9	-0.5%	2.8	4.7%	3.0	2.0%	3.0	
		2,000,000	2.3	-3.5%	2.2	-1.1%	2.2	6.6%	2.4	0.8%	2.4	
		10,000,000	1.8	-3.5%	1.8	-1.8%	1.7	9.3%	1.9	0.3%	1.9	
NTS	Firm loads	200,000,000	1.0	-3.5%	1.0	-8.2%	0.9	0.0%	0.9	0.0%	0.9	
NTS	Interruptible loads	200,000,000	0.6	-3.5%	0.5	-8.2%	0.5	0.0%	0.5	0.0%	0.5	

Note: Domestic changes shown assume a standard meter.