

TRANSCO CONSULTATION REPORT ON PD17

Setting of NTS Transportation Charges

1. Transco's Initial Proposal

Transco's Pricing Discussion Paper PD17 was issued to encourage consideration of whether the present framework for NTS transportation charge setting was still the most appropriate given that Licence restrictions on revenue and the uncertainty associated with both the maximum level of allowed revenue and the actual revenues likely to be achieved could lead to frequent changes in price levels. In some instances, large price level changes might be necessary to comply with Licence requirements.

In this context, the PD17 set out the present arrangements for setting both gas and electricity transmission charges and highlighted the effects of each. It then looked at alternatives to the present procedure for gas transmission charges and sought respondents' views on whether changes to the present framework for NTS transportation charge setting should be pursued.

These issues are much less significant for the setting of gas distribution charges since there is much less uncertainty in the level of both the maximum allowed LDZ revenue and the actual LDZ revenue and less likelihood of significant divergence between the two. Although the paper concentrated on the setting of the NTS transportation charges, responses relating to the setting of LDZ transportation charges were also encouraged.

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

2. Summary

There were twelve responses to the consultation paper.

Shippers & Suppliers	
British Gas Trading	BGT
ConocoPhillips	CON
Innogy	INN
PowerGen	PG
Scottish Power	SP
Scottish & Southern Energy	SSE
Shell Gas Direct	SGD
Statoil	STA
TotalFinaElf	TFE
Other Interested Parties	
Association of Electricity Producers	AssEP
Corus	COR
Individual	I

Seven respondents supported the proposal that charges should be set once a year (BGT CON INN PG SP SSE AssEP). Two respondents (SGD COR) welcomed the prospect of more stability or less frequent changes. One respondent (STA) suggested that charges should be reviewed at 6 monthly intervals. One respondent (I) suggested an alternative approach.

Seven respondents (CON INN PG SP SSE STA AssEP) supported changes to the Licence so as to enable charges to be set normally only once a year whereas two respondents (BGT TFE) were not supportive of this principle. Three respondents (CON SSE AssEP) supported removal of the interest rate differential on over/under recoveries. Five respondents (BGT INN STA COR I) supported its retention.

Five respondents (CON INN STA AssEP I) supported the setting of limits on the level of over recovery that might automatically be carried forward from one year to the next. One respondent (SP) stated a preference for no limits and one respondent (SGD) suggested that the limits should be widened.

Eight respondents supported the retention of PC65 methodology (BGT INN PG SP SGD STA TFE COR), three (CON SSE AssEP) suggested that revisions to the PC65 methodology would be appropriate and one (I) suggested that the PC65 methodology was only necessary in the absence of a TO commodity charge.

Five respondents (BGT PG TFE COR I) felt a TO commodity charge was an appropriate way to handle variations in the level of TO revenue. Four of these suggested that this should be in addition to the PC65 methodology. Two respondents (CON STA) felt the introduction of a TO commodity charge would create more uncertainty. One respondent (INN) suggested that further consideration of a TO commodity charge was appropriate. Two respondents (SP AssEP) had some reservations about such a charge.

Eleven respondents (BGT CON INN SP SSE SGD STA TFE AssEP COR I) did not support a possible move to ex-post charge setting. One (PG) did not specifically refer to this issue.

There were no responses specifically referring to LDZ charges.

3. Detailed Responses

3.1 Frequency of Changes to the Level of Charges

The majority of respondents were in favour of increased stability with as few as possible price changes during the year. Annual or six monthly changes would appear to be acceptable.

One respondent (TFE) specified that it was more concerned with the magnitude of price changes rather than the frequency of changes. Another (STA) stated that very large changes should be avoided.

Three respondents (SP SSE AssEP) referred to the notice period for price changes. Short notice was not welcomed and two of the above respondents specifically requested an increase in the notice period to three months.

Three respondents (PG SSE AssEP) commented on the timing of price changes. Their comments were all different. One (PG) suggested aligning the charging formula year with the gas year, one (SSE) suggested aligning the charging year to the formula year and one (AssEP) did not specifically state a preferred time for price changes.

Transco's Response

It remains Transco's aim to minimise the number of price changes during the year and also to avoid very large price changes. Where possible a smoothed approach is the preferred option. However, recent Licence modifications in conjunction with the variations in expected revenues (primarily relating to the revenues from the entry capacity auctions) have resulted in an increase in the number and magnitude of price changes.

Subject to its Licence constraints on over/under recovery of revenues Transco has where practicable given 150 days notice of indicative price levels and two months notice of revisions to transportation charges. Transco would welcome Licence changes that would further facilitate this aim.

Transco believes there are merits to scheduling price changes at predictable times and endeavours to do so wherever practicable. Further consideration of the appropriate timings of planned price changes will be made.

3.2 Possible Changes to the Licence

The majority of respondents were in favour of modifications to the Licence to reduce the necessity for frequent price changes. With regard to the potential allowable level of over/under recovery, the majority that commented would expect limits to this level. One respondent (CON) suggested that

the carry forward amount should be related to the change in the charges rather than to the target revenue. One respondent (SP) specifically suggested that there may be instances when the community should be given the opportunity to decide whether an adjustment should take place, for instance when Transco suggests a large price change might be appropriate. The majority of those that commented specifically on the interest rate differential suggested that this should remain to give Transco an incentive not to over recover.

Transco's Response

Transco would not welcome an allowed over/under recovery amount that was related to a change in charges rather than a preset target since this would add further uncertainty to the charge setting process. Licence modifications that allowed more flexibility in the allowed level of over/under recovery would reduce the need for price changes, necessary at present, to ensure the over recovery stays within the existing allowable plus 4% target. The existing interest differential on over recoveries provides an incentive on Transco not to over recover. However this may also provide an unwanted incentive on Transco to make adjustments to the charge level within the year.

There may be instances when it is desirable to consult with the industry before making large price adjustments. This was the case when there were large over recoveries resulting from the capacity auctions. Subject to complying with any existing Licence conditions, Transco may wish to consult with the industry in such exceptional cases. However, it is preferable that in the normal course of events, there is an established approach in place to reduce the uncertainty for both Transco and the industry.

3.3 Retention of PC65 and the Introduction of a TO Commodity Charge

The majority of respondents favoured the retention of the PC65 methodology although it may be appropriate to revise the methodology to accommodate changes to the capacity auctions.

Of the respondents that specifically commented on the introduction of a TO commodity charge, the majority considered it an appropriate method for dealing with auction over/under recoveries. Of these respondents, the majority suggested that the TO commodity charge should supplement, rather than replace, the PC65 methodology.

Two respondents (CON STA) felt the introduction of a TO commodity charge would create more uncertainty. One respondent (INN) suggested that further consideration of a TO commodity charge was appropriate. Two respondents (SP AssEP) had some reservations about such a charge.

Transco's Response

Given that there was considerable support for retention of the PC65 mechanism, possibly with some minor modifications, Transco recommends revisiting the co-existence of this mechanism alongside the possible introduction of a TO commodity charge. This could provide an alternative to adjusting exit capacity charges to deal with the problem of over/under recoveries. A disadvantage of a TO

commodity charge in addition to the PC65 mechanism is that the uncertainties associated with the level of buy –back costs will flow through into uncertainties over the appropriate level of such a TO commodity charge.

A TO Commodity charge would not be introduced without further consideration of the method of application. Rather than create more uncertainty, a TO commodity charge could be used to provide a more certain way of returning over recoveries or collecting under recoveries (arising primarily from uncertainty surrounding entry capacity revenues) whilst not distorting the auction bidding process.

3.4 Possible move to Ex-Post Charging for the SO Commodity Charge

There was no support amongst the respondents for the SO Commodity charge to be set in a similar method to NGC's BSUoS charge.

Transco's Response

Respondents have requested stable charges rather than charges which recover the precise target revenue. Where it is necessary to make changes to charges as much notice as possible is preferred. Transco therefore has no plans at present to develop such proposals for the SO commodity charge.

3.5 Alternative Suggestions

One respondent (I) suggested an alternative option to setting charges once a year. The proposal was to allow quarterly price changes subject to two months notice of charges for the following quarter and at the same time publication of indicative charges for the four quarters after that. This procedure could be repeated on a quarterly basis.

Transco's Response

This suggestion has the merit of predictability in terms of the timing of potential price changes. Indicative charges published up to 5 quarters ahead should minimise the number of shocks to shippers and assist with longer term planning within the industry. However there will still be situations where large price changes may be necessary to comply with licence requirements to cope with unexpected variations in allowed or recovered revenue.

3.6 Other Comments

Two respondents (BGT INN) commented that the introduction of the Long Term Auctions for entry capacity should reduce the volatility in the TO revenue and make predictions easier.

One respondent (SGD) expressed concern that the under recovery was due to not charging on storage flows.

Transco's Response

It is too early to determine whether the Long Term auctions will reduce the volatility in the TO revenue. In any case, unless the majority of entry capacity is sold further ahead there is still the potential for significant variations in the TO revenues.

The under recovery is not due to not charging on storage flows since revenue estimates were revised prior to setting charges under this assumption.

4. Conclusion

Transco welcomes the comments received in response to the proposals contained within PD17. A wide variety of views on many of the issues raised within the discussion paper have been aired. However it is clear from the responses that some change to the methodology for setting NTS transportation charges is desirable.

In light of the comments received, Transco proposes to consider further the introduction of a TO commodity charge as a means of handling potential over or under recovery resulting from auction outcomes. Related to this, and also to the developments in the means and frequency of auctioning entry capacity, Transco will also consider whether possible changes to the application of the PC65 mechanism should be made. Transco expects to issue a Pricing Consultation paper on the definitive changes proposed to the charging methodology in these respects shortly.

Transco also intends to enter into discussions with Ofgem with a view to seeking changes to the Licence that would allow greater flexibility in the charge setting process.