

Modification Report
Requirement for Publication of Transco's Revenue Flows against target
Modification Reference Number 0670

Version 1.0

This Modification Report is made pursuant to Rule 7.3 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification Proposal

On a monthly basis Transco would be required to provide information on the aggregate sums invoiced to Shippers in respect of each of the various Transportation charge types. This information would be published by means of a monthly budget statement (suggested format attached) for each Price Control (NTS TO, NTS SO & LDZ (separated from 1 April 2004)). Information included in the monthly statement would be:-

- Total billed for the prior month, by transportation charge type. NB These should be total billed figures not adjusted for disputes and queries.
- Running total for the (price control) year to date.
- Transco's reasonable estimate of revenue recovery for each charge type for each month, with aggregate for year to date, profiled to reflect Transco's forecast of capacity sales and energy throughput.

Information should be published no later than [Xth] of each month following completion of Transco's monthly invoice production cycle (not invoice due dates).

2. Transco's Opinion

Transco's interpretation of the Proposal is that the requested financial information is on a retrospective basis and hence that Transco would not be required to provide forecasts of its income were this Proposal to be implemented. Transco would emphasise, however, that it believes the provision of forward-looking information could be seen as being price-sensitive, as it would provide an early indication of income for the relevant year.

At present, Transco's Gas Transporter Licence contains provisions governing its level of allowed revenue, the process by which it reports on performance against its revenue controls, and the process to be followed when amending the level of transportation charges. This is consistent with the regulatory frameworks of other UK network operators. This system appropriately focuses oversight of relevant revenue issues onto the regulatory authority, and Transco does not believe it would be appropriate to overlay an alternative process via Modification to the Network Code.

Contrary to the Proposer's suggestion, Transco does not believe that publication of the information requested would decrease the risk associated with the setting of charges to customers. This is because the information requested seeks to help identify any potential over- or under-recovery in a formula year, which is only

one factor relevant to the determination of the future level of charge rates and the timing of any changes to these rates.

Transco understands Shippers' concerns over the volatility and predictability of transportation charges. Transportation charge rates have been particularly volatile in recent years, the key drivers for which have been the separation of the transmission and distribution price controls (including the separation of transmission into TO and SO price controls), and the introduction of NTS entry capacity auctions. The combination of these factors has given Transco very few degrees of freedom to ensure recovery of revenue in line with its price control allowances, and particularly to avoid recovering more than the maximum allowed revenue. Furthermore, the timing of the auctions and the inevitable uncertainty associated with their outcomes have materially affected the predictability of actual revenue from NTS entry charges. However, offsetting changes to other charge types has stabilised the level of transportation revenue collected from Shippers rather than introducing volatility. That is, the unit rates vary in order to keep the total collected stable, and within the limits allowed by Transco's price controls.

On the transmission side, it has been argued that the introduction of long term system entry capacity auctions and the move to annual monthly system entry capacity (AMSEC) auctions will enhance the predictability of actual NTS TO revenue. In turn, this should help to bring more stability to NTS charge rates. Furthermore, Transco proposes to introduce an NTS TO commodity charge, which would allow NTS exit capacity charges to be maintained at levels consistent with the recovery of 50% of allowed NTS TO revenue. Transco has recently published its Consultation Report for PC77, in which the NTS TO commodity charge was proposed. In this report, Transco set out the circumstances under which it would expect to use the charge, which it was hoped would provide greater certainty and clarity for Shippers regarding the potential level of the prospective TO commodity charge. Whilst this Pricing Consultation has been vetoed by Ofgem, Transco proposes to issue a further consultation on a TO revenue redistribution mechanism which would address the issues raised in the PC77 consultation.

Transco believes that remaining concerns about volatility in charges, covering both distribution and transmission charges, are best addressed through appropriate Licence provisions rather than through the provision of information such as that requested in this Modification Proposal. In this respect, Transco notes Ofgem's proposals in respect of the Electricity Distribution Network Operators which potentially provide a precedent for the gas networks in terms of the treatment of under- and over-recoveries and the appropriate notice period to be given when changes to transportation charge levels are proposed.

Transco believes that the developments outlined above are significant in the context of the Proposer's objective of decreasing the risk associated with the setting of charges to customers. This is in contrast to the proposed information provision that is the subject of this Modification Proposal, which Transco does not believe would help Shippers in the way suggested.

In the consultation on this Modification Proposal Transco welcomed views on the implications which its implementation might have for the electricity market. While no impact on the physical interaction of energy transmission systems

would be anticipated, implementation of this Proposal could be seen as setting a precedent for other Network Operators who could also be asked to publish financial information that has previously only been supplied to the Authority.

3. Extent to which the proposed modification would better facilitate the relevant objectives

The Proposer suggests that implementing this Modification Proposal would better facilitate competition between Shippers and Suppliers. It is unclear to Transco how the provision of the requested information would achieve this, and respondents' views on this would be welcome.

4. The implications for Transco of implementing the Modification Proposal , including

a) implications for the operation of the System:

No direct implications are anticipated.

b) development and capital cost and operating cost implications:

Changes to Transco's existing systems would be required to facilitate the provision of this information. Some additional operating costs due directly to the information release would also be expected.

c) extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:

Any additional costs incurred as a result of implementing this Proposal would be accounted for under Transco's operating costs and allocated between the LDZ and NTS TO price controls, and the NTS SO internal costs incentive scheme. Costs attributable to the SO incentive scheme would be reflected in subsequent levels of the SO Commodity Charge, while other costs would be reflected in revenue allowances when the TO price controls are next modified.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Implementation of this Proposal would not be expected to impact price regulation.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

It is not anticipated that there will be a change to the level of contractual risk to Transco as a consequence of this Proposal.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

Changes to Transco systems would be required to facilitate the provision of information, the precise details of which are unclear in the absence of definitions of the information items being sought. Users may also wish to develop systems to receive the published data.

7. The implications of implementing the Modification Proposal for Users

Users would have an indication of Transco's collected revenues against each charge type.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

Transco would welcome views from the above parties on any anticipated implications.

9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

No changes to contractual relationships are anticipated.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages:

- The Proposer believes the provision of this information would decrease the risk associated with the setting of charges to customers and support effective competition between Suppliers.

Disadvantages

- Transco believes the provision of this information may be misleading as it does not represent all the elements that impact upon transportation charges.
- Increased administrative complexity and operating costs for Transco.

11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Transco received a total of 8 responses to this Modification Proposal :

British Gas Trading Ltd (BGT)
Powergen UK plc (POW)
Total Gas & Power Ltd (TGP)
EDF Energy (EDF)
Shell Gas Direct (SGD)

Scottish Power (SP)
RWE Innogy (RWE)
Scottish & Southern Energy (SSE)

The first five names listed above supported implementation of the Proposal, and the last three were opposed to the Proposal. However even the respondents who did not support the Proposal (SP, RWE, SSE) shared the Proposer's concerns about the recent frequency of price changes, but they did not agree that implementation of this Proposal would be the best way of meeting those concerns, and could increase uncertainty. Generally they favoured longer notice periods for price changes rather than the implementation of this Proposal. Transco is also opposed to implementation of this Modification Proposal. The reasons for this are well summarised in the response from SP who stated that "there may be more appropriate information which could be shared, that possible licence changes may be more appropriate, and that the publication of pricing discussion papers could all offer favourable alternatives to the current proposal".

Appropriateness of the Data Requested

The Proposer has requested income for the most recent month, and for the cumulative position in the year to date. The information was requested for each of the relevant charge types aligned to the three main Forms of Control, with the figures not adjusted for disputes and queries. One respondent (POW) said that the information would be very useful for those who seek to predict future transportation costs. Another respondent (TGP) said that "publication of revenue information will allow shippers to obtain information with respect to over/under-recovery of revenues, reducing the prospect that unforeseen variations in revenue will result in fluctuations in transportation charges." EDF said it understood Transco's point of view that publication of the data would not necessarily give an accurate indication of when and by how much transportation charges are going to change, but believed it was a first step towards the industry becoming more informed. SGD supported the Proposal because of the recent volatility of price changes.

Transco Response

The responses from POW and TGP suggested that there may be some misunderstanding about what the requested information would provide. It would not provide information on under or over recovery of revenues. In addition, provision of the information would not, in itself, reduce fluctuations in transportation charges, and it is debatable whether it would make them more predictable. Although SGD supported implementation of the Proposal because of the recent volatility of price changes, it did not indicate how implementation might reduce the frequency of price changes, and Transco does not believe it would do so. Transco believes that there are other and more effective ways of providing increased certainty about future price changes.

Transco agrees with SSE who stated that, with respect to the information requested, "it is difficult to see how this could be interpreted or used in any meaningful way". Transco believes that the provision of monthly information could cause uncertainty as things can change from month to month, and that the measures outlined in section 2 of this report would be more helpful in reducing any risks associated with the setting of charges to customers.

Request for Additional Information

The proposer (BGT) stated that "Transco should be obliged to publish their own estimates, currently used internally, together with the assumptions which have been applied in their preparation".

Transco Response

The request to publish internal estimates and the assumptions behind them is not part of the original Proposal and so cannot be considered as part of this Modification Report.

Appropriateness of Modifying the Network Code to Require Publication of Information

The Proposer has requested a monthly budget statement of the information referred to above, as part of an amendment to Section S of the Network Code.

Transco Response

Transco does not believe that it is appropriate to provide information under amended Network Code terms in addition to existing Licence requirements to provide information. These requirements are generally to provide annual and one-off information. The proposed Pricing Discussion paper could be used to discuss whether it would be appropriate to release to the shipping community some of the information supplied to Ofgem.

Competition Between Suppliers

Several respondents (POW) (TGP) (SGD) suggested that implementation of the Proposal would improve competition between Shippers and between Suppliers by making changes in charges either less frequent or more predictable.

Transco Response

Transco does not agree that implementation of the Proposal would in itself make changes in charges either less frequent or more predictable. Transco believes that there are other and more effective ways of improving the information provided to the industry and is happy to progress these, initially through the publication of a Pricing Discussion paper.

Increased Operating Cost

One respondent (TGP) said that they understood Transco's concerns that implementation of the Proposal would create increased operating costs but felt that this cost was justified given Transco's position as the incumbent monopoly gas transporter.

Transco Response

Transco would emphasise that any increased cost will be taken into account in the next Periodic Review and will therefore be passed through to Shippers and their customers in due course.

Proposed Pricing Discussion Paper

Several respondents enquired whether/when Transco would publish a Pricing Discussion paper.

Transco Response

As stated in the response to Modification Proposal 0655, Transco proposes to issue a paper in the near future in which some of the points raised by Modification Proposals 0655 and 0670 can be discussed further.

Other Comments

Price Sensitivity: One respondent (POW) stated “We do not understand Transco’s concern in regards to price sensitivity as all Users would receive the same information at the same time and so no commercial advantage can be gained from the provision of such information”.

‘K Information’ Withdrawn from the Transportation Statement: One respondent (POW) noted “that Transco have published their over/under-recovery in previous Gas Transportation charges ... We are unaware of the reason behind Transco’s decision to stop publishing such information”.

Transco Response

Price Sensitivity: The sensitivity is in respect of supplying such information publicly such that the City would be able to see it, not that it gives one Shipper advantage over another. In addition to Licence and Network Code compliance, Transco clearly needs to take account of other obligations, such as Stock Exchange requirements.

‘K Information’ Withdrawn from the Transportation Statement: While it is some years since K information was published in the Transportation Statement, similar information was published in discussion papers dealing with the balance of charges, namely PD14 (November 2001) and PD16 (November 2002). There was no similar publication in November 2003 but this was due to the absence of any plans to change the balance or structure of charges at that time. The publication of similar information in the future can be discussed in the planned Pricing Discussion paper.

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation

Transco does not believe that implementation of this Modification Proposal would affect compliance with safety or other legislation.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

Not applicable.

14. Programme of works required as a consequence of implementing the Modification Proposal

A programme of works would need to be developed should the Modification Proposal be implemented.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

Transco does not recommend implementation of this Proposal.

16. Recommendation concerning the implementation of the Modification Proposal

Transco recommends rejection of this Proposal for the reasons outlined above.

17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

18. Transco's Proposal

This Modification Report contains Transco's proposal not to modify the Network Code and Transco now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

19. Text

Signed for and on behalf of Transco.

Signature:

Mike Calviou
Commercial Frameworks Manager
NT & T

Date:

Gas and Electricity Markets Authority Response:

In accordance with Condition 9 of the Standard Conditions of the Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco that the above proposal (as contained in Modification Report Reference **0670**, version **1.0** dated **13/01/2004**) be made as a modification to the Network Code.

Signed for and on Behalf of the Gas and Electricity Markets Authority.

Signature:

The Network Code is hereby modified with effect from, in accordance with the proposal as set out in this Modification Report, version **1.0**.

Signature:

Process Manager - Network Code
Transco

Date:

Annex

1. Any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which The Restrictive Trade Practices Act 1976 ("the RTPA"), had it not been repealed, would apply to this Agreement or such arrangement shall not come into effect:
 - (i) if a copy of the Agreement is not provided to the Gas and Electricity Markets Authority ("the Authority") within 28 days of the date on which the Agreement is made; or
 - (ii) if, within 28 days of the provision of the copy, the Authority gives notice in writing, to the party providing it, that he does not approve the Agreement because it does not satisfy the criterion specified in paragraphs 1(6) or 2(3) of the Schedule to The Restrictive Trade Practices (Gas Conveyance and Storage) Order 1996 ("the Order") as appropriate

provided that if the Authority does not so approve the Agreement then Clause 3 shall apply.
2. If the Authority does so approve this Agreement in accordance with the terms of the Order (whether such approval is actual or deemed by effluxion of time) any provision contained in this Agreement or in any arrangement of which this Agreement forms part by virtue of which the RTPA, had it not been repealed, would apply this Agreement or such arrangement shall come into full force and effect on the date of such approval.
3. If the Authority does not approve this Agreement in accordance with the terms of the Order the parties agree to use their best endeavours to discuss with Ofgem any provision (or provisions) contained in this Agreement by virtue of which the RTPA, had it not been repealed, would apply to this Agreement or any arrangement of which this Agreement forms part with a view to modifying such provision (or provisions) as may be necessary to ensure that the Authority would not exercise his right to give notice pursuant to paragraph 1(5)(d)(ii) or 2(2)(b)(ii) of the Order in respect of the Agreement as amended. Such modification having been made, the parties shall provide a copy of the Agreement as modified to the Authority pursuant to Clause 1(i) above for approval in accordance with the terms of the Order.
4. For the purposes of this Clause, "Agreement" includes a variation of or an amendment to an agreement to which any provision of paragraphs 1(1) to (4) in the Schedule to the Order applies.