

OFGEM DECISION LETTER No. 0536

**"Temporary Waiver of Two Months Notice Period to Effect a Change to Transco's
Transportation Charges"
Version 2.0**

Direct Dial: 020-7901 7437

16 May 2002

Transco, Shippers and Other Interested Parties

Our Ref: Net/Cod/Mod/536

Dear Colleague,

Modification Proposal 0536 '*Temporary Wavier of Two Months Notice Period to Effect a Change to Transco's Transportation Charges*'

Ofgem has considered the issues raised in Modification Proposal 0536, '*Temporary Wavier of Two Months Notice Period to Effect a Change to Transco's Transportation Charges*'.

Before proceeding to confirm the decision that Ofgem has reached in respect of this modification proposal, Ofgem considers that it is appropriate to clarify some matters surrounding the modification proposal.

Ofgem notes that one respondent raised the issue that this modification proposal sought prematurely to anticipate the outcome of the statutory consultation process under section 23 of the Gas Act 1986 to introduce changes to Transco's Gas Transporter's (GT) licence price control provisions for the period April 2002-07. Ofgem considers it appropriate to address any concerns that industry participants may have on this matter.

Any decision placed before the Authority under amended standard condition 9 (Network Code) of Transco's GT licence has to be assessed against the criteria set out therein having regard to the Gas Act 1986, Authority's duties, the licensees duties and all relevant facts.

In essence in respect of this modification proposal, this means that it has to be assessed against the background of the licence and the network code as they exist today - not as they may be in the future as a result of a consultation process which has not yet been concluded. There are circumstances where it may be appropriate to have regard to imminent changes to a licence or regulatory regime in order to assess whether the changes meet the relevant criteria. Here it is appropriate to note the existence of the SO Final Proposals and the s23 notice proposing these changes, however, it is inappropriate to make assumptions about how these could be translated into licence obligations as these are currently being consulted upon.

Ofgem published licence modifications in respect of Transco's price control for the period 2002 – 07 for statutory consultation under section 23 of the Gas Act 1986 on 12 April 2002. This consultation does not close until Friday 24 May 2002. Following consideration of the consultation responses and Transco's decision in respect of the proposed modifications, one

possible consequence of this statutory consultation process is that further changes to Transco's Network Code **may** be necessary to implement changes to Transco price control for the period 2002-07. Another possibility **may** be that Ofgem will reconsult on the proposed modifications having regard to consultation responses. As such, no conclusion on the effects of the proposals can be drawn simply from the mere fact that they are being consulted upon.

In reaching its decision on whether this modification proposal meets the criteria set out in amended standard condition 9 of Transco's GT licence, Ofgem has noted that Transco has stated that the rationale behind the decision is to enable timely implementation of the SO Final Proposals. For the reasons stated above, no assumptions can be made that these licence modification proposals will be implemented in the form consulted upon. The basis for considering whether to direct that this modification be made is set out in amended standard condition 9 of Transco's GT licence, in particular whether the modification will better facilitate the relevant objectives. Having regard to the criteria set out in amended standard Condition 9 of Transco's GT licence, the Gas Act 1986 and all other relevant factors and for the reasons set out in the Ofgem views section of this letter, Ofgem has decided to direct Transco not to implement this proposal.

In this letter, we explain the background to the modification proposal and give the reasons for making our decision.

Background to the proposal

Currently, Transco levies transportation charges on users of its National Transmission System (NTS) and Local Distribution Zones (LDZ) to recover its allowed revenue as determined under its price control. The charging methodology for recovering its annual allowed revenue from system users is governed by obligations set out in Transco's GT licence. In particular, Transco is required to ensure that its charges reflect its costs incurred in its transportation business. In addition, Transco is required to take all reasonable steps to set transportation charges such that revenue from such charges does not exceed its price controlled allowed revenue in any given year.

Currently, for the NTS, transportation charges comprise an entry capacity charge (determined through capacity auctions), exit capacity charges and a throughput based commodity charge intended to recover the costs of Transco's system operations function. Transco may from time to time make changes to the manner in which it recovers its allowed revenues through its charges. Any changes to these arrangements would need to be initiated by Transco through a pricing consultation proposal and would need to be consistent with the relevant charging methodology objectives set out in amended standard condition 4A of Transco's GT licence.

Transco may also periodically adjust the level of its transportation charges. For instance, because entry capacity is sold through an auction mechanism, where revenues received in these auctions suggest that Transco may exceed its allowed revenue for a particular year, charges may be adjusted to ensure Transco does not over recover against this allowed revenue. Under the provisions of its GT licence Transco must use reasonable endeavours to give the Authority notice of a proposal to change its charges at least 150 days before the proposed date of implementation.

Under the current network code arrangements, Transco is required to provide no less than two months notice prior to the implementation of any revised transportation charges.

The proposal

This modification proposal provides that Transco would not be required to give the minimum two months notice of changes to its transportation charges in respect of the period 1 March 2002 to 30 April 2002. Instead, Transco would be required to give notice as far in advance of the date on which the proposals contained therein are to be implemented as is reasonably practicable and no later than 1 April 2002.

Respondents' views

Of the eight respondents who commented on the modification proposal, the majority opposed the proposal.

A number of respondents who were opposed to the modification argued that the waiver of the two months notice period would result in uncertainty in transportation charges that would undermine competition between shippers and would be detrimental to the interests of customers. One respondent argued that the additional uncertainty created by the modification would defeat the objective of the proposal, whilst another argued that the proposal would increase the uncertainty over the likelihood of such waivers being used again.

One respondent, opposed to the proposal, stated that well established and codified processes should be retained whenever possible to provide certainty to industry participants. In this respect, another respondent argued that repeated changes to and deviations from due process reduced the authority and perceived legitimacy of industry codes.

Another respondent argued that the rules regarding the implementation of revisions to transportation charges were incorporated in the network code for reasons of good governance and therefore in the future both Ofgem and Transco should work together within a common timetable that ensures compliance with the network code. This respondent however reluctantly supported the proposal on the basis that there was little point in delaying the inevitable change to Transco's transportation charges as this would simply result in higher charges in May due to a loss of revenue in April 2002.

One respondent said that the two month notice period should not be waived as it provides sufficient time for any changes in transportation charges to be appropriately reflected by shippers/suppliers.

One shipper stated that the proposal pre-supposed elements of Transco's GT licence which had yet to be published and consulted upon and questioned how Ofgem would be able to make a judgement about how well this modification would facilitate compliance with the efficient discharge of Transco's obligations.

A number of other respondents expressed concern in responding to the proposal without knowledge of the SO incentives proposals and in the absence of the licence proposals having been implemented. In this respect one respondent stated that revisions to charges would only become apparent once Ofgem issued its licence consultation but accepted that once this consultation has occurred a modification may be necessary to reduce the two months notice period for changes to transportation charges. This respondent however indicated that in principle it is not in favour of shortened notice periods for changes to transportation charges. The respondent stated that changes of this nature make it difficult for suppliers to accurately forecast transportation costs and compete for new customers thus frustrating competition.

A number of respondents stated that they were unable to support the proposal in its current form. One respondent argued that the proposal was not sufficiently detailed and that Transco should provide additional information concerning the period of notice it considers sufficient to provide users, the length of time the waiver should apply for and the specific transportation charges that are to be revised. Another respondent acknowledged that the SO incentive regime is likely to impact on some elements of Transco's transportation charges and that these are likely to be specifically targeted to the SO NTS User charge. This respondent went on to suggest that the use of a waiver should be restricted to the SO NTS User charge and not applied to all transportation charges.

Transco's view

Transco believes that this proposal is necessary to enable the timely implementation of Ofgem's final proposals in respect of Transco's NTS SO incentives scheme, but acknowledged that it would create uncertainty for users and potentially for customers, in respect of the level of transportation charges from 1 April 2002.

In response to concerns expressed by some respondents that the proposal was too wide, Transco stated that it had not specified the adjustments to transportation charges that would be made using the proposed waiver because it could not be certain of the nature of changes to its charges in advance of agreement of the provisions of its GT licence.

Transco stated that revisions to transportation charges would enable Transco to comply with its GT licence provisions. Therefore, Transco argued that the modification proposal would facilitate compliance with the efficient discharge of its GT licence obligations.

Ofgem's view

Ofgem agrees with concerns expressed by respondents that, as a general principle, it is undesirable to reduce the notification period for adjustments to transportation charges as set out in the network code. In particular, Ofgem considers that adjustments to this notice period may increase uncertainty for shippers and customers in terms of transportation charges. This may undermine competition to the detriment of customers. Conversely however, Ofgem also recognises that there may be occasions where it is appropriate to waive these notice periods, for example to prevent potential distortions in competition (e.g. changes may be necessary to adjust transportation charges following any over or under recovery in respect of entry capacity auctions).

However, in the case of this proposal, Ofgem does not accept the position outlined by Transco in its final modification report that the proposal would facilitate compliance with the relevant objective of the efficient discharge of Transco's obligations under its GT licence. In particular, Ofgem considers that it is not possible to determine whether the modification better facilitates this objective in circumstances when the proposed modifications to Transco's licence are to be the subject of a consultation that is yet to be completed.

As outlined previously, Ofgem has commenced a statutory consultation under section 23 of the Gas Act 1986 on the proposed modifications to Transco's GT licence. Any modifications to Transco's GT licence are therefore subject to the outcome of this consultation process. Accordingly, it would be inappropriate to assume that such changes will be implemented and to judge this proposal against Transco's '**anticipated**' licence obligations.

In addition, it would be unreasonable to assess the modification proposal on the basis of an expectation that transportation charges must necessarily change as a result of the licence consultation process. Ofgem notes in this context that Transco has itself indicated that it cannot be certain of the nature of the changes to its transportation charges prior to the provisions of its GT licence provisions being agreed.

Ofgem also shares respondents' concerns that this modification proposal is too wide and uncertain in so far as it enables Transco to adjust any transportation charges. In particular, Transco has not indicated the specific charges to which the waiver relates and has not in these circumstances sought to provide a rationale for the proposal other than by reference to its anticipated licence obligations following the outcome of the statutory consultation. In this context a reduction in the two month notice period for changes to transportation charges would create undesirable uncertainty for shippers and customers.

Ofgem's decision

For the reasons outlined above Ofgem has decided to direct Transco not to implement this modification proposal because we do not consider that it will better facilitate the achievement of the relevant objectives as outlined under amended standard condition 9 of Transco's GT licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

Mark Feather
Head of New Gas Trading Arrangements