



Shippers, Transco and other interested parties

*Empowering choice and value
for customers.*

Our Ref: net/cod/mod/0655
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17 March 2004

Dear Colleague,

Modification proposal 0655 'Price change notification periods'

Shell Gas Direct Ltd raised modification proposal 0655 on 10 October 2003.

Ofgem has considered the issues raised in this modification proposal and all responses received and has decided to direct Transco not to implement this proposal because we do not consider that it would allow Transco to better facilitate the relevant objectives as set out under standard condition 9 of the Gas Transporter (GT) licence.

In making this decision, Ofgem had regard to Transco's obligations under its GT licence, its wider statutory duties and all relevant facts.

The reasons for this decision are set out below.

Background

Currently, Transco levies transportation charges on users of its National Transmission System (NTS) and Local Distribution Zones (LDZs) to recover its price control allowed revenue. The charging methodology for recovering its annual allowed revenue from system users is governed by obligations set out under 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 allowed revenue in any given year.

Under the current NTS arrangements, transportation charges comprise an entry capacity charge (determined through long-term capacity auctions), exit capacity charges and a throughput based commodity charge.

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 to shippers prior to the implementation of any revised transportation charges.

Recent pricing consultations

In July 2002, Transco raised pricing consultation paper 75 *NTS TO Commodity charge* (PC 75). Under this proposal Transco would set an NTS TO commodity charge to reflect the forecast level of TO revenue relative to the maximum allowed TO revenue. Respondents to the consultation were concerned that because of the lack of detail in Transco's proposed methodology, it would be difficult to predict the level of charges and the frequency of changes to the charge.

In January 2004 Transco published a report on pricing consultation paper 77 *NTS TO commodity charge* (PC 77). Transco proposed that an NTS TO commodity charge could be introduced, in addition to the NTS SO commodity charge. The charge would be used to adjust the level of the TO revenue if there was forecast to be significant over or under recovery of TO revenue against the maximum allowable TO revenue from April 2004. Respondents expressed the need for charging stability and for an appropriate targeting of revenue under or over recovery to system users.

Ofgem vetoed PC 75 and PC 77 respectively and indicated that Transco should give consideration to providing clarity in its proposed charging methodologies, where possible revise its transportation charges only once a year and provide sufficient notice to shippers of changes to charges.

Modification Proposal 0670 Requirement for publication of Transco's revenue flows against targets

British Gas Trading (BGT) raised modification proposal 0670 in November 2003. Under this proposal Transco would be required on a monthly basis to provide information on the aggregate sums invoiced to shippers in respect of each of the various transportation charges. BGT considered that the monthly publication of this information would provide greater transparency for shippers and suppliers. Ofgem is giving due consideration to the merits of this proposal.

The proposal

Under modification proposal 0655, Transco would be obliged to publish changes to charges at least three months ahead to provide greater certainty to the market. Transco would also be required to publish indicative prices six months prior to implementation. In raising this proposal Shell Gas Direct considered that Transco should use its best endeavours to inform shippers as soon as practicable of any changes to its assumptions or data which could have a material effect upon published prices.

Respondents' views

There were ten responses to this modification proposal. All of the respondents supported the proposal although a minority offered qualified support.

Price stability

Shippers suggested that the proposal would provide increased stability for Transco's charges and that this would have the following benefits:

- it would reduce the risks faced by shippers
- suppliers would have better information on which to base their charges to final consumers and
- shippers would have more time to analyse and comment on proposed changes to charges.

Increased transparency

One respondent considered that the proposed additional measures would be helpful in bringing increased transparency to charging. It suggested that Transco could set up a pricing / transportation charging workshop to examine how prices are set and how the revenues interact with the various incentives schemes and charging arrangements

Other respondents suggested that if Transco were required to provide data and assumptions, shippers and suppliers would be able to predict price changes over future periods with greater accuracy.

Frequency of changes to charges

Several respondents commented on the frequency of changes to charges. One respondent considered that Transco should only be allowed to change charges up to four times in one gas year to bring stability to prices. Another respondent considered that transportation charges should be set on a per annum basis in order to minimise the number of changes to charges.

Qualified support

Of those respondents who offered qualified support, one respondent stated that it remained to be convinced that providing one extra month's notice would result in any adverse material differences arising from this proposal, particularly bearing in mind the lagged effect that Transco faced when accounting for actual revenues under the segregated price control regime.

One respondent suggested that indicative prices published six months in advance could be less accurate than the current arrangements.

Transco's views

Transco did not support this proposal. It stated that increasing the indicative notice period to 6 months would not serve any useful purpose as it would make indicative notice less accurate and therefore of less value.

Transco noted that increasing the notice period from two to three months could be counter-productive, as giving earlier notice could mean that the price changes are less appropriate when they do take effect, so that further price changes may be required to correct any errors.

Frequency of changes to charges

Transco considered that adjusting its ability to make changes to charges would require a licence modification. It considered that charging and revenue recovery procedures had been made more complex by the introduction of three separate price controls, which require it to adjust SO, TO and LDZ transportation charges independently, in accordance with Transco's price control.

150 days notice

Transco suggested an alternative mechanism to the original modification proposal. It suggested that Transco would use reasonable endeavours to notify the Authority and shippers of proposed changes to charges, at least 150 days ahead.

Ofgem's views

Ofgem supports the principle of introducing greater stability to Transco's transportation charging arrangements. However, this proposal does not appear to effectively address shippers' and suppliers' concerns regarding potential uncertainty and instability of Transco's charges, the frequency of within year changes to charges and the lack of detail surrounding Transco's charges and revenue flows.

Ofgem considers that publishing indicative charges six months in advance could lead to inaccurate forecasts of revenue over or under recovery, which would not assist shippers and suppliers in setting prices.

The provision of indicative adjustments to charges does not guarantee charging stability for shippers and suppliers, in particular where there is a large discrepancy between the indicative and final adjustments to charges. For example, on 29 July 2003 Transco considered that there was considerable uncertainty surrounding the level of revenue from monthly system entry capacity auctions but it did not expect to levy a change in charges. Following this notification, Transco announced in October 2003 that it would raise NTS TO exit charges by 5.5 % from 1 December 2003 and by 6.5% from 1 April 2004¹.

Ofgem reiterates the importance of stability and certainty of charges for customers and suppliers. However, taking into account all relevant information and experience to date with regard to notification of changes to charges, Ofgem does not consider that the publication of indicative changes to charges six months in advance would better facilitate competition between shippers and suppliers compared to the current network code provisions.

While the proposal to increase Transco's notification to shippers from two months to three months would be helpful, Ofgem acknowledges Transco's suggestion that it could provide increased notice of changes to transportation charges to all system users in line with its

¹ 4 July 2003, Transco pricing note to shippers; and 29 September 2003, Transco pricing note to shippers, NTS Exit capacity charges from December 2003 and Gas Transportation charges effective from 1 October 2003

current licence obligations to provide 150 days notice to the Authority. Without fettering its discretion Ofgem considers that there is merit in such an alternative proposal and that it could bring greater benefits to shippers than the proposed three month notice period. However we recognise that the 150 days notice concept is not part of this proposal. Transco or shippers would need to raise a modification proposal in order to incorporate the 150 days notice of changes to charges within Transco's network code.

Ofgem's decision

Accordingly Ofgem has directed Transco not to implement this modification proposal, as we do not consider that it would better facilitate the achievement of the relevant objectives as outlined in amended standard condition 9 of Transco's GT licence for the reasons outlined above.

If you require any further information in relation to this modification please feel free to contact me on the above number or Tolani Azeez / Matteo Guarnerio on telephone 0207 901 7043/ 7493.

Yours faithfully



Andrew Walker
Director, Transmission
Networks