Modification Report
Amendment to Optional National Transmission System (NTS) Commodity Rate requirements to input gas at the local entry point
Modification Reference Number 0600

Version 3.0

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

The Proposer described the Proposal as :

"To amend the rule applied to determine the NTS Commodity Charge payable, so that provided the aggregate Users' Daily Quantity Input at the Specified Entry Point is greater than or equal to the User Daily Quantity Offtaken at the relevant Specified Exit Point(s), the NTS Optional Commodity Rate would apply to all gas offtaken at the relevant Exit Point. That is, the NTS Optional Commodity Rate would apply irrespective of the quantity of gas input at the Specified Entry Point by that User or Users (in the case of a Shared Supply Meter Point). Where there is more than one relevant Exit Point, eligibility for the NTS Optional Commodity Rate would be pro-rated to exit nominations.

(For the avoidance of doubt this modification proposal would not alter the rules in Section B.3.5.5.(i) which determine how a User nominates the Supply Point that it wishes to qualify for the NTS Optional Commodity Rate.)"

2. Transco's Opinion

When the Optional NTS Commodity Rate was introduced the Network Code was modified to include the requirement that the daily offtake quantity at a site would attract the Optional NTS Commodity rate only in respect of gas delivered by that User at the local "elected" entry point. This was consistent with the cost-reflective principles of the tariff, namely that it should reflect the alternative cost of providing a stand-alone pipeline from the local entry point to the site. This Proposal might be considered to maintain this principle because aggregate flow at the local entry point is required to be no less that the volume offtaken at the relevant site or sites. However, if the User did not input gas at the local entry point then it might be considered inappropriate to apply a reduced commodity rate given that the User could not have contemplated a direct bypass without gas available at that specified entry point.

Transco notes that the condition included in the Proposal in respect of aggregate input quantities relative to each site's offtake quantities would require a set of business rules to be developed that would determine the daily offtake quantities to be charged at the Optional NTS rate and those to be charged at the standard rate. Transco attached a set of draft business rules to the Draft Modification Report, containing a potential methodology. Since no comments were received on these rules, subject to an Ofgem decision, Transco would consider it appropriate to implement the Proposal in line with the proposed business rules.

Transco is not aware of any impacts implementation of this Proposal would have on the electricity regime.

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

In the Proposer's view, the Proposal would better facilitate the relevant objectives of facilitating competition in gas shipping and supply and the efficient and economic operation of the system:

It would incentivise loads in close proximity to entry terminals to consume gas from the NTS, reducing the probability of a constraint arising.
It would discourage large loads and offtakes from bypassing Transco's system particularly where there are risks of a constraint situation and high entry capacity costs, by providing an economic incentive for such loads to utilise Transco's system. As a result, costs to all users should reduce in the longer term.
It would facilitate the optimum delivery of gas to the system as Users shipping gas to such Supply Points would have the freedom to source gas from alternative locations to the Specified Entry Point.
It would enable shippers to trade available entry capacity with other shippers and Transco, further developing a liquid capacity market and as a result potentially reducing constraint management costs to the benefit of shippers and Transco.
It would ensure that large loads and offtakes located near to entry terminals receive cost-reflective transportation commodity charges.

In Transco's view, implementation could increase competition between shippers/suppliers at relevant supply points. Transco recognises that the greater flexibility in delivering gas at entry points might impact the extent of entry capacity trading although whether the effect would be to increase or decrease liquidity is not clear. Transco considers that implementation of the Proposal is unlikely to increase the risk of NTS bypass, since end-users considering an NTS bypass would need to have access to gas supply contracts at the local terminal. Additionally , the likelihood of constraints is not necessarily reduced, as it depends on the exact cause and location of each constraint, which may not necessarily be affected by the continuation of offtake quantities by the relevant large load.

Transco has an objective to comply with other licence obligations. Under the licence Transco is obliged to develop a transportation charging methodology that is cost-reflective. This Proposal may undermine the cost-reflective principle of the optional NTS charge.

Thus Transco concludes that whilst implementation of the Proposal might have benefit in the context of increasing competition in respect of supply to relevant supply points it would be detrimental to the principle of cost-reflective charging inherent in the current application of the Optional NTS Commodity Rate.

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

a) implications for the operation of the System:

Transco envisages no implications for the operation of the System.

b) development and capital cost and operating cost implications:

Implementation would require development of changes to administration and billing systems at an estimated cost of around £50,000.

No impact on operating costs would 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:

The development costs would lead to higher SO internal costs than otherwise. Through the SO internal cost incentive scheme, this would be expected to lead to a higher NTS SO standard commodity charge than otherwise enabling Transco to retain revenue which would offset part of the additional costs.

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

Implementation would be expected to lead to an increase in the offtake quantities billed at the Optional NTS Commodity rate. It is forecast that this could result in a reduction in SO commodity revenue of 2% which would need to be offset by an increase in the standard SO commodity charge of 2% to retain the same revenue level.

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

No such consequences are anticipated.

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

Implementation would require the development of changes to administration and billing systems to accommodate the requirement in the Modification Proposal that the aggregate of all Users' daily input quantities at each relevant entry point would need to be monitored against the offtake quantities for the affected supply points.

Transco has not been made aware of any implications for Users' computer systems.

7. The implications of implementing the Modification Proposal for Users

Users with supply points on the Optional NTS Commodity charge are likely to see a reduction in transportation charges, as a result of an increase in the portion of the offtake quantities billed at the Optional NTS rate.

Such Users would have greater flexibility in respect of which entry points they choose to deliver gas, without it affecting the extent to which the Optional NTS Commodity charge is applied.

All other Users would be likely to see at some stage an increase in the NTS (SO) commodity rate of around 2%.

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

Large load consumers charged on the Optional NTS Commodity charge may receive a reduction in annual charges depending on the nature of the transportation agreement with their Shipper/Supplier. However, consumers charged on the standard NTS commodity rate may see an increase in their transportation charges, depending on their individual supply contract, to reflect the expected 2% increase in the SO commodity rate.

Those large loads that could potentially benefit from the Optional NTS Commodity charge would benefit from an increase in the number of Shippers/Suppliers they choose to contract with, as potential Shippers would not need to have in place delivery contracts at the local entry terminal.

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 such consequences are anticipated.

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

Advantages :

May reduce the likelihood of NTS bypass, consistent with the objective of the Optional NTS Commodity charge.

Affected Users would benefit from greater flexibility in choosing which entry points to deliver gas.

May be considered to be cost-reflective, in that where insufficient gas is input in aggregate by all Shippers at the local terminal to meet the offtake quantities, the standard commodity rate would apply only to those quantities deemed not to have been delivered locally.

Disadvantages :

May be considered to reduce the cost-reflectivity of the Optional NTS Commodity charge in that it would apply in cases where the Shipper was not inputting equivalent quantities at the local entry point to the offtake quantity. In these circumstances, it may be considered that the alternative of a stand-alone pipeline to the local terminal would not be practical and so the justification for the Optional NTS Commodity charge as an alternative to a stand-alone pipeline is not valid.

Requires changes to the administration and billing systems used for the application and auditing of the Optional NTS Commodity charge.

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

Representations were received from the following ten parties :

ConocoPhillips	(CP)
Innogy	(Inn)
Powergen	(PG)
British Gas Trading	(BGT)
London Electricity Group	(LE)
Shell Gas Direct	(SGD)
Statoil UK	(Stat)
Total Fina Elf	(TFE)
Scottish & Southern Energy	(SSE)
Scottish Power	(SP)

Of these, three respondents (CP, SSE, Stat,) expressed support for the Proposal, one respondent (SP) expressed qualified support and six respondents (BGT, LE, SGD, TFE, PG, Inn) did not support the Proposal.

Interaction with Modification 0214 (Optional NTS Commodity Charge)

The majority of respondents not in support of the Proposal argued that Shippers that sourced gas from other entry points should not benefit from a reduced NTS commodity charge, and that such quantities should be charged at the standard NTS commodity charge. They also suggested that the proposed change to the Network Code rules would undermine the existing principles of the optional NTS commodity charge, as introduced by Modification 0214.

LE observed that the Optional NTS Commodity Rate was there for the purpose of disincentivising Users building their own pipework to deliver gas to an Offtake point close to the NTS. As such, it agreed that this gave Shippers the right investment signals to build new loads close to the Entry points where the original source of gas comes from and not the NTS. TFE described the outcome (of the Proposal if implemented) as a resultant “distortion of the correct cost analysis necessary to justify whether or not to build a stand-alone pipe”. It also commented that removing the requirement to link deliveries to the local terminal would erode and potentially blunt the signals regarding the demand for capacity at the specified entry point and would send inappropriate signals regarding the demand for others. TFE argued that the current rules should be maintained to ensure appropriate incentives exist to deliver sufficient gas at the local entry point.

BGT observed that Ofgas (at the time) commented in their decision letter to Modification 0214 (18 May 1998) that shippers should face the incentive to arrange local delivery of gas if they wished to benefit from the discounted shorthaul tariff. Innogy argued that the availability of this tariff should be linked to the requirement to physically deliver gas at the 'local' terminal, and that without this, the basis of the tariff would need to be redesigned. SGD suggested that the continuing operation of the optional commodity tariff was sufficient in itself in discouraging loads from bypassing the NTS and receiving cost-reflective tariffs.

SP expressed qualified support on condition that the system benefits obtained (if any) could be shown to outweigh the disadvantage of increased cost to the community. It recognised that the Proposal could simplify the existing arrangement by extending the application of the short haul tariff and could strengthen the incentive to locate new gas load in a way that was beneficial to the system. However, SP suggested that the benefits outlined in the Proposal already exist with the existing shorthaul arrangements, and whilst this modification may provide substantial rewards for existing relevant loads, it was uncertain whether the methodology would encourage location of new build load in less load sensitive areas.

In support of the Proposal, SSE observed that since the optional rate was introduced the economics at play have changed significantly, and now act to incentivise such loads to bypass the NTS completely. The costs and risks associated with securing NTS entry capacity at the relevant entry point, it argued were not commensurate with the economic benefits of the NTS operational commodity rate, thus making NTS bypass a more attractive option.

SSE commented that if the customer purchased gas from the NBP, the actual physical flow of gas to the site would still be from the local terminal. In its view, therefore, it was not appropriate for the customer to be charged the standard commodity transportation rate, as the gas was only travelling a very short distance, from the terminal to the offtake. SSE also argued that it would be more efficient and economic for the load to be incentivised to consume gas from the NTS but not be restricted to landing gas at the local terminal to qualify for the optional rate, particularly if there was a greater propensity for constraints at that entry point. A further benefit, SSE argued, of removing the local terminal rule was that it would enable shippers to trade available entry capacity with other shippers and Transco, further developing a liquid entry capacity market.

STUK suggested that the modification would assist the optimum delivery of gas to the NTS as Shippers who ship gas to various supply points would have the freedom to source gas from alternative locations. STUK put forward the view that the implementation of this proposal would promote competition by enabling customers to choose suppliers and shippers based on price rather than only having a limited choice from those shippers who land gas at a particular entry point.

SP commented that the modification had proceeded to consultation without adequate exploration of the benefits or costs to the system, and to users, and further suggested that the consequences of this modification should be discussed with the Association of Electricity Producers, the major users groups and other customer representatives prior to implementation.

System Entry Constraints

Three respondents (SGD, BGT, LE) commented on the Proposer's view that implementation of the Proposal could reduce the probability of constraints arising. SGD argued that Transco's existing commercial tools were sufficient to manage constraints, and that generally encouraging consumption throughout the year did not appear to be appropriate to resolve constraints which tended to occur only on certain days. LE suggested as an alternative, that the "local terminal" was removed only on days of constraints at that terminal. BGT argued that constraints would arise from physical flows, therefore whether the gas being consumed at a specific offtake was commercially sourced at NBP was irrelevant.

Transco's response

As commented on by a number of respondents, Modification 0214 was introduced to facilitate the application of the Optional NTS Commodity charge that was intended to discourage the likelihood of large loads located close to entry points bypassing the NTS. Consistent with the methodology for the new charge, the Modification introduced the "local terminal rule" to Network Code.

Since its introduction, Transco recognises that NTS entry prices at certain entry points have increased. However, the introduction of the optional NTS charge was intended to offer an alternative to the standard NTS commodity charge, rather than to offset or correct any impact arising from changes in NTS entry charges, and therefore Transco believes that issues associated with NTS entry prices should be kept separate to the principles of the optional NTS charge. Although the Proposer states that "the present need to hold entry capacity is not cost-reflective", since the introduction of NTS entry capacity auctions, Transco has not been obligated to set entry capacity prices in a cost-reflective manner.

Transco believes that the requirement that the optional NTS charge is payable only on those quantities delivered to the local elected terminal was recognised to be consistent with the basis of the tariff, and it would agree with those respondents that have suggested its removal would undermine the cost-reflective principles. As commented in Section 2, consideration could only be given to constructing a standalone pipeline where the User would be intending to deliver gas at the local entry point.

Transco would also question the Proposer's view that large offtakes close to entry points help to alleviate constraints, since constraints may arise at points further into the system, and may be unaffected by the quantities offtaken at large loads close to entry points.

Transco would observe that the Modification Proposal and a draft set of business rules have already been the subject of discussion at Industry Workstream meetings. Details on implementation costs and impacts on transportation charges were contained in the Draft Modification Report.

Transco sees merit in some of the perceived benefits of the Proposal that, in the Proposer's view, implementation would provide, such as a possible improvement in the opportunities for entry capacity trading. However, Transco is also aware that one of the conditions in the approval of Modification 0214 was that the optional NTS tariff should only apply in respect of gas delivered at the local terminal. Implementation of Modification Proposal 0600 could arguably create an inconsistency between the Network Code and the principles of the optional NTS tariff charging methodology, although a degree of cost-reflectivity would still arguably be retained by the condition, suggested in the Proposal, that sufficient gas is flowed from the local terminal, in aggregate, to qualify for the lower rate.

Impact on Transportation Charges

Four respondents (Inn, SP, PG, TFE) expressed concern about the potential impact on costs for users on the standard commodity rate, with two of these describing the increase (in the NTS (SO) charge as inappropriate and unfair.

Innogy observed that although the effects would be 'relatively small', the distributional impact could be exaggerated where those avoiding the full commodity rate would also avoid procuring capacity at the (relatively) expensive local ASEP.

SP suggested that the potential extension of this arrangement to all ASEPs would be likely to have a significant system impact going forward. It also expressed concern over the allocation of benefit between customer, shipper or operator. SP further questioned where the benefit would be applied with the split of the SO commodity charge between Entry and Exit to be introduced from October 2003. It requested consideration of the potential implications for the negotiation of third party access to pipelines, and the consequences of application of similar arrangements to the LDZs.

Two respondents (STUK, SSE) expressed doubt regarding Transco's statement that implementation of the Proposal would lead to an increase in the NTS(SO) commodity rate of 2% due to the Optional charge becoming more preferable to shippers. STUK questioned whether implementation would lead to an increase in the number of supply points that could opt for the lower commodity charge. SSE commented that non-implementation of the Proposal would deter loads and offtakes from continuing to use the NTS, which would also have the potential to reduce SO commodity revenues. STUK drew attention to Transco's statement that it was envisaged there would be no change to the NTS (SO) commodity charge to apply from 1st January 2003 in the 2003/2004 formula year.

Transco's response

Transco can advise that the proposal to split the NTS (SO) commodity charge between Entry and Exit would not be expected to affect either the level or the application of the optional NTS commodity charge. It is anticipated that Users choosing the optional NTS charge would forego the need to pay the standard NTS commodity charges, irrespective of the final forms these charges will take.

Transco's assessment of the potential impact on the SO commodity revenue was based on the anticipated increase of offtake quantities billed at the optional NTS rate of those loads already elected to be charge at the lower rate. For example, during the period of the previous Gas Year, around two thirds of the offtake quantities of sites on the optional tariff were billed at the lower rate. The revenue impact assessment was made on the assumption that implementation of the Proposal would result in 100% of offtake quantities being billed at the lower rate. Any impact from additional supply points opting for the lower commodity rate would be expected to be minimal.

Cost-reflectivity / Cross Subsidisation

Three respondents (BGT, LE, SGD) suggested that the Proposal, if implemented, would introduce a cross-subsidy to the benefit of Users on the Optional NTS charge, and would lead to inappropriate cost-targeting.

Two respondents (LE, BGT) suggested that the costs of delivering gas at the local entry point would be borne by other Users. LE argued that it seemed logical and reasonable to expect that Users on the optional NTS charge to pick up these costs, and therefore that implementation would not lead to more efficient transportation costs.

Transco’s response

The optional NTS charge reflects the costs of building a dedicated pipeline and does not reflect a target level of costs based on any historical cost assessment.

In respect of any impact of entry costs on other Users, Transco would observe that the costs of delivering gas is determined by the entry capacity prices paid by Users and would not be affected by the outcome of the Proposal.

Administration Systems

SSE expressed surprise at the high costs and lead times required to introduce the change and modify Transco's systems as there would only need to be a small change to the way in which invoices would be validated. It observed that the only change under the Proposal would be for Transco to reconcile against the aggregate UDQI, instead of the individual shipper's UDQI and requested that more information be provided about the changes that Transco considered to be necessary.

Transco’s response

The administration and billing of the optional NTS tariff are undertake on offline systems, and as commented by the respondent, changes would be required to these systems to reflect the amended validation rules. In addition to the changes from individual UDQI’s to aggregate UDQI’s in reconciling to the appropriate charge, changes would be needed to take account of entry points with more than one shipper on the optional charge in the event of a “shortfall” of gas delivered locally, the details of which would depend on the precise business rules for allocation. Development of systems would also have to take account of DM reconciliation and any consequential adjustment in the offtake quantities being charged at the respective rates.

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

No such requirement exists in respect of the Modification Proposal.

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

No such requirement exists in respect of the Modification Proposal.

14. Programme of works required as a consequence of implementing the ModificationProposal

No changes to UK Link are envisaged and therefore a Programme of Works is not required.

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

At this stage, a complete implementation timetable has not been produced, but the lead-time for implementation to allow for development and testing of systems would be expected to be around three to four months.

16. Recommendation concerning the implementation of the Modification Proposal

In light of the responses received in respect of this Proposal and due consideration of the likelihood of furthering the relevant objectives, Transco does not recommend implementation of the Proposal.

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:

NT & T

Date: