

Modification Report
URGENT Modification Reference Number 0226

'Equitable Allocation of RbD Savings and Compensation for Small I&C Sites'

This Modification Report is made pursuant to Rule 9 of the Modification Rules and follows the format required under Rule 8.12.4.

1. Circumstances Making this Modification Proposal Urgent:

In accordance with Rule 9.2(a) Ofgas has agreed that this Modification Proposal should be treated as Urgent to facilitate prompt discussions on how these sites are to be treated.

2. Procedures Followed:

Transco agreed with Ofgas (and has followed) the following procedures for this Proposal;

7 / 4 / 98	-	Modification Proposal forwarded to Ofgas
15 / 4 / 98	-	Ofgas agreed Modification should be treated as Urgent
21 / 4 / 98	-	Urgent Modification Proposal circulated to shippers inviting representations
5 / 5 / 98	-	Close out for representations
21 / 7 / 98	-	Final Modification Report to Ofgas

A number of unforeseen issues arose during May and June which Transco has now resolved.

3. The Modification Proposal:

The modification proposes a method whereby AQ appeals can be facilitated on I&C Sites with an AQ <2,500 tpa, to enable them to be reconciled at a meter point level. It further proposes a mechanism for compensating I&C shippers for the administrative costs of processing RbD invoices for these sites and appealing the AQs to avoid RbD. The modification also outlines a framework for transferring sites from RbD to meter point reconciliation, to ensure accurate reconciliation.

The detailed proposals of this Modification are:-

1. AQ appeals should be facilitated on sites where;

(a) They are supplied by a shipper under Condition 35 of its Licence;

(b) The site had an AQ >2,500 tpa prior to the 1997 AQ Review, but were recalculated to <2,500 tpa but >1,925 tpa by that review and have not been subsequently appealed to >2,500 tpa; or

(c) Supply points with an AQ <2,500 tpa following the 1998 review, which do not fall into categories a) or b) where the shipper believes the site will consume >2,500 tpa in future years.

2. Following an AQ appeal, the modification proposes that Transco undertake a calculation of the capacity charges that have been invoiced from 1st February 1998 to 1st October 1998 and those that would have been charged had the site AQ been revised at that time.

3. Where there is a difference for Supply points in categories a) and b), Transco to undertake an adjustment of the transportation charges and reimburse the shipper.

4. Transco to provide a special meter reading within a one week window surrounding effective date of the appealed AQ.

5. Transco to offer a liability payment of £50 per supply point for sites that fall within categories a) and b), to compensate the shipper for the additional administrative effort required to process manual RbD invoices and appeal the AQ.

4. Transco's opinion:

Transco does not support this modification. It is recognised that for I&C shippers, there may be a need for a pragmatic solution to avoid them having to develop RbD functionality to process a limited number of I&C sites that currently have an AQ <2,500 tpa. To facilitate this, Transco has proposed a process under Modification 0208 to allow shippers to appeal the AQ for these sites to >2,500 tpa to enable them to be reconciled at a meter point level. However, this process will only come into effect once the supporting appeal functionality is available. This is currently scheduled for release in September 1998.

Transco has a number of concerns with the framework proposed by this modification, which are detailed below:

(i) Transco believes that for the majority of these sites, the AQ should be <2,500 tpa. By allowing shippers to appeal these sites to >2,500 tpa, the shipper will change its transportation charges. Transco would suggest that this change may mitigate any financial effects of shippers processing these sites within the RbD regime and raising an appeal. Furthermore, shippers are not obliged to raise the AQs of these sites, the option to leave them as they are and process relevant reconciliation amounts as part of RbD remains. Transco has concerns that introducing a liability payment may incentivise shippers to raise AQ appeals they may not otherwise have raised. Transco therefore believes that compensation, in the form of a liability payment, is inappropriate.

(ii) The modification proposes no controls over those sites that can be appealed to >2,500 tpa under category c) and appears to suggest that these appeals would be based on prospective use, rather than historical consumption. "Prospective" AQ appeals cannot be validated at the time of the appeal, therefore there are not controls

over the volumes of appeals that could be raised under this category. Consequently Transco has no control over the financial exposure it may face in respect of the special meter reads proposed by this modification. Furthermore, as no validation of supply points in categories a) and b) is proposed, Transco has no control over the potential numbers of sites that may be appealed and is therefore further exposed in respect of the liability payments and transportation adjustments proposed. The proposal, as it stands, incentivises shippers to undertake these appeals by offering sums of money in excess of the value of the issue. Consequently, shippers could be forced into diverting resources into this activity simply to accrue the compensation payments even if they were initially prepared to accept RbD for the affected sites.

(iii) The requirement for a meter read to be taken at the time of a site transferring from RbD to meter point reconciliation is considered inappropriate. Modification 0146 was implemented specifically to avoid the need for opening reads for AQ changes. Transco believes that as long as there is an estimate at the time of the change between the two processes, this should avoid any potential issues with double counting. If shippers have remaining concerns with this issue, it is suggested that these should be raised via the Network Code Rationalisation Workstream.

Transco is considering how "smaller" I&C supply points can be excluded from RbD in the longer term without the need for the AQ to be appealed to >2,500 tpa (e.g. by flagging the Supply Point for meter point reconciliation). Transco believes that this is the most appropriate solution and is working towards having this functionality available during 1999. In the interim, Transco acknowledges the requirement for these sites to be excluded from RbD once the full RbD functionality goes live and has therefore initiated changes to the systems to enable these sites to be appealed to >2,500 tpa and therefore be subject to meter point reconciliation. A proposal for appealing these sites has been included in the Final Modification Report for Modification 0208. However, the process proposed by Transco provides greater control over the categories of sites that can be appealed and therefore restricts the opportunities for shippers to benefit from inappropriate AQ appeals.

5. **Extent to which the proposed modification would better facilitate the relevant objectives:**

In the modification proposal, one of the consequences of not implementing this proposal is stated as:

"shippers will have been exposed to unnecessary administration not catered for in the margins to which they operate. This modification ensures Transco better facilitate meetings its relevant objectives by securing effective competition between shippers and suppliers."

In Eastern's opinion, this is how Transco's relevant objectives would be better facilitated.

6. **The implications for Transco of implementing the Modification Proposal , including:**

a) **implications for the operation of the System and any BG Storage Facility:**

Transco is not aware of any such implications.

b) **development and capital cost and operating cost implications:**

Implementation of this Modification will involve Transco in significant costs in administering any AQ appeals, calculating transportation charges and processing of any adjustments, provision of special meter reads and significant liability exposure. There may be additional associated systems costs, which have not yet been fully scoped.

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:**

Costs associated with implementing and operating this modification will be treated as ordinary business costs and will be dealt with as regulated operating costs. Any liability / compensation payments would be treated outside of formula costs.

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

Transco is not aware of any impact on price regulation.

7. **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:**

This modification sets a number of precedents, such as the provision of meter reads as sites move between reconciliation mechanisms, and risks incentivising shippers to change their AQs and change the method of reconciliation at the expense of the accuracy of other transportation charges. Also, the compensation payment system proposed under this modification does not have a pre-determinable volume of transactions and, as such, potential payouts are not quantifiable.

Transco does not believe these precedents are in the best interests of the industry in the longer term. Transco also feel it is important to point out that the proposed level of compensation payments is disproportionate to the reconciliation amounts levied through RbD in respect of the affected sites.

8. **The development implications and other implications for computer systems of Transco and related computer systems of Relevant Shippers:**

Significant changes will be required to Transco's computer systems to enable these sites to be appealed to >2,500 tpa and reconciled at a meter point level. These are already being progressed under the remit of Modification 0208. Additional Network Code changes would be necessary to undertake the re-calculation of capacity charges (and any subsequent adjustments) and to calculate and monitor any liability payments. Transco is not aware of any implications on the computer systems of relevant shippers, other than a general requirement to process RbD amounts when they are included on the Reconciliation invoice.

9. **The implications of implementing the Modification Proposal for Relevant Shippers:**

This Modification will enable I&C shippers to appeal certain categories of sites with AQs currently less than 2,500 tpa to values greater than 2,500 tpa, thus avoiding RbD from 1st October 1998 onwards. It will also compensate shippers for any associated administrative costs. In many cases, shippers will benefit from inappropriately reduced transportation charges following such AQ appeals.

10. **The implications of implementing the Modification Proposal for terminal operators, suppliers, producers and, any Non-Network Code Party:**

Transco is not aware of any such implications.

11. **Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each Relevant Shipper and Non-Network Code Party of implementing the Modification Proposal:**

Transco is not aware of any such consequences.

12. **Analysis of any advantages or disadvantages of the implementation of the Modification Proposal:**

Advantages - The modification allows I&C shippers to avoid the administrative costs associated with processing RbD adjustments dealing with a potentially small number of I&C Sites that currently have an AQ <2,500 tpa.

Disadvantages - The proposal does not address the ongoing issue of sites that may cross the 2,500 tpa threshold year on year following an AQ review and may therefore move between RbD and meter point reconciliation.

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

Nine representations have been received for Modification 0226.

Representations were received from Eastern Natural Gas, Shell Gas Direct, Mobil Gas Marketing, Texaco, BGT, Agas, BP Gas and Scottish Power.

One shipper did not support the Modification, three shippers did not support it as worded but said that many of the issues raised required further discussion, and five shippers supported the Modification.

Four shippers suggested that Transco should investigate and prioritize alternative ways of facilitating meter point reconciliation for smaller I&C sites on all partitions, without the need to appeal the AQ for those sites to >2,500 tpa. The method suggested by two of these shippers was that sites should be able to be flagged for meter point reconciliation, regardless of the AQ. One shipper stated that assuming an AQ greater than 2,500 tpa was unacceptable and that meter point reconciliation is necessary to correctly ascertain the transportation charges. One shipper also commented that the proposal to appeal sites to above 2,500 tpa was inappropriate without a framework to address the pricing implications on existing contracts. Transco recognises that appealing Aqs to >2,500 tpa is not the preferred solution and it is proposed as an interim measure only. Transco supports the suggestion of flagging sites for meter point reconciliation without changing the AQ, and is working towards developing this functionality for availability during 1999.

Two shippers stated that RbD works for a large normally distributed sample size, but its accuracy when applied to a small bias sample was unknown. One shipper further suggested that I&C shippers were unlikely to have 1,000 supply points <2,500 tpa in their portfolio, nor in each LDZ, and were therefore exposed to RbD risks. They commented that this was unlikely to be great in financial terms but was not countered by any resource savings.

Several of the representations commented on the discontinuity in the pricing methodology around the 2,500 tpa threshold, which has been suggested offers potential gaming opportunities to shippers appealing sites to above the threshold. Three of the representations commented that Transco should seek to address this issue through revisions to the charging structure, to avoid any potential gaming opportunities.

One shipper suggested that, whilst AQ appeals should be facilitated as proposed by this Modification, no relief should be allowed from the correctly levied transportation charges. They further suggested that Transco should separately invoice any consequential changes in the charges arising from an appeal, until the charging methodology has been revised to eliminate the discontinuity.

A number of shippers made a number of comments relating to the additional resource and expense that I&C shippers were having to expend as a result of RbD (which was inconsistent with the concept of benefit sharing). It was suggested that Transco should compensate shippers for this additional cost. One shipper stated that this should not involve any adjustment of transportation charges, (as proposed by the modification,) as this would involve additional resource costs. They proposed that alternatively Transco make a compensatory payment of £50 per site in an I&C shippers portfolio that is currently subject to RbD, with an additional payment for every month that the site could not be appealed to >2,500 tpa. A further shipper said that £50 compensation was appropriate.

One shipper suggested that if this Modification was approved, Transco would be in breach of its obligation to secure effective competition between shippers and suppliers, and not to show undue preference or discrimination, as it would be offering a facility to I&C shippers/suppliers that would not be available to domestic shippers/suppliers.

One shipper suggested that it was inappropriate that borderline sites should move between reconciliation processes following every AQ review. They further suggested that Small Sites (other than Condition 35) had to demonstrate that their offtake exceeds 2,500 tpa in order to secure an I&C contract, and that it should therefore be designated as I&C and kept out of RbD irrespective of future AQ reviews. They further stated that they believed that proposals 1) and 5) of the Modification should be implemented as a minimum, and suggested that an appeal window should be opened with immediate effect.

One shipper submitted a lengthy analysis highlighting the price discontinuity around the 2,500 tpa threshold. This was raised by several other shippers in their representations, as mentioned above. Transco recognises that this is an issue. The proposal made by Transco under Modification 0208 is offered as a short term solution only, to enable I&C shippers to avoid developing RbD functionality. Transco would suggest that shippers need to make a commercial decision whether to take advantage of the appeals facility, based on an assessment of the likely benefits and costs. The issue with the pricing discontinuity has been raised and will be considered within the next pricing review.

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

Not applicable.

15. **The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 3(5) of the statement; furnished by Transco under Standard Condition 3(1) of the Licence:**

None.

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

Under the previous proposals for dealing with Condition 35 sites put forward by Transco under Modification 0208, there will be the requirement to develop UK-Link functionality, to enable "smaller" I&C sites to be appealed to an AQ of >2,500 tpa. This is scheduled to be operational for October 98.

17. Proposed implementation timetable (inc. timetable for any necessary information systems changes):

Transco do not propose a timetable for implementation.

18. Recommendation concerning the implementation of the Modification Proposal:

Transco recommend that the modification is rejected and the necessary changes made through Modification 0208.

19. Restrictive Trade Practices Act:

Not applicable.

20. Transco's Proposal:

This Modification Report contains Transco's proposal for non-implementation of this proposed modification to the Network Code and Transco now seeks direction from the Director General in accordance with this report.

21. Text provided pursuant to Rule 9:

Not applicable.

Signed for and on behalf of Transco.

Signature:

John Lockett
Manager, Network Code

Date:

21. 7. 98

Director General of Gas Supply Response:

In accordance with Condition 7 (10) (b) of the Standard Conditions of Public Gas Transporters' Licences dated 21st February 1996 I hereby direct Transco (that the above proposal as contained in Modification Report Reference 0226, version 1.0 dated 14/07/98) to reject this proposal as a modification to the Network Code.

Signed for and on behalf of the Director General of Gas Supply.

Signature:

Kyran Hanks
Director of Transportation Regulation

Date: