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Dear Dr Lockett

**MODIFICATION 226 - EQUITABLE ALLOCATION OF RBD SAVINGS AND  
COMPENSATION FOR SMALL I&C SITES**

I refer to the above final modification report, received by Ofgas on 22 July 1998. Ofgas has considered the proposed modification and has decided that, although there are aspects of the proposal that we believe would better fulfil Transco's relevant objectives, we cannot consent to the proposals as presently packaged.

The modification's proposals may be categorised as falling into three parts. First, providing compensation to shippers who have unnecessarily found need to process ad hoc reconciliation by difference (RBD) invoices. Second, the rebate of transportation charges. Third, the future treatment of sites inappropriately assumed to consume below 2,500 therms a year. We take each of these in turn.

**1. Reconciliation by Difference Invoices**

It has been proposed that Transco should provide £50 payments to shippers for some sites that are inappropriately affected by RBD. Specifically, it is proposed that sites supplied under Standard Condition 35 of the supplier's licence and sites that inappropriately have an AQ below 2,500 therms because of Transco's 1997 AQ review should prompt such a payment.

Shippers have said that before Ofgas accepted the adoption of RBD, Transco made commitments to industrial and commercial (I&C) shippers about the treatment of sites wrongly considered to consume below 2,500 therms a year and sites covered by Condition 35 of the suppliers licence. In Ofgas' letter of 15 April, in which we decided that Modification 226 should be treated as urgent, we concurred with shippers' view.

It is inefficient and uneconomic that the whole community should be put to increased operating costs because Transco does not undertake work that is reasonably expected of it. Also, RBD is a statistical process that can only be relied upon to produce accurate and economic charges if a shipper has large numbers of sites that are affected by it. While I&C shippers continue to have relatively few sites inappropriately drawn into RBD, they may therefore be

subject to uneconomic charges. Transco should have incentives to undertake whatever remedies are necessary to improve its charges in this respect.

We would envisage supporting proposals that were designed to compensate I&C shippers for the costs of inappropriately processing RBD invoices (where sites are not actually domestic sites) and that gave Transco an incentive to improve the accuracy of its charges in the future. Shippers and Transco may wish to consider bringing forward modification proposals in this area. We would expect any such proposal would need to provide evidence of the costs incurred by shippers. It would also need to address how to differentiate between sites that genuinely consume below 2,500 therms a year and those that I&C shippers can reasonably expect should not be subject to RBD (for example, Condition 35 sites and sites for which the AQ was inappropriately reduced during the 1997 AQ review).

## **2. The Rebate of Transportation Charges**

As part of the 1997 AQ review, Transco may have calculated sites to have AQs below 2,500 therms when, in fact, the site should have been allocated an AQ above this threshold. Transco has not previously provided shippers with a chance to amend AQs below 2,500 therms and, therefore, there has been no opportunity for shippers to correct these inaccurate AQs. Shippers have suggested that, as a result, they have been over charged for the transportation of gas because sites with an AQ below 2,500 therms were charged higher transportation prices under Transco's charging structure in 1997/98. This modification proposes that Transco reduce the transportation charges to sites supplied under Condition 35 of the supplier's licence and sites inappropriately assumed to consume below 2,500 therms a year.

To recalculate transportation charges in the way suggested is, to some extent, to retrospectively change the basis by which Transco calculates its charges. It is currently a feature of Transco's charging methodology that corrections to inaccurate AQs normally only have effect prospectively (for example in respect of capacity charges or transportation charges). Although this feature may be inappropriate and may be something that should be amended in the future, it was the basis for charges in 1997.

Shippers do not dispute that the AQ for sites supplied under Condition 35 of the supplier's licence were accurate (it was only suggested that the AQ for these sites would be amended in order to exclude them from RBD). Therefore, for these sites, transportation charges have not been levied inappropriately. It may be the case that sites that were inappropriately assumed to consume below 2,500 therms a year were charged inaccurately by Transco. However, any shipper affected will have been able to offset against the higher transportation charges the cashflow benefit of not being required to provide as much gas initially as their customers were, in fact, consuming (for the very same reason that the customer's AQ was understated). Also, the benefit of re-opening these charges would need to be off-set against the cost to shippers of recalculating, checking and querying these adjustments.

On the basis of the information available to Ofgas, we are not convinced that this aspect of the modification would correct a clear case of an inappropriate cost allocation. Therefore, we have decided against making a retrospective change to the basis by which Transco charges shippers, in this instance.

Looking forward, work has already been put in hand to address one aspect of the cost of having a site inappropriately allocated an AQ below 2,500 therms. That shippers pay larger transportation charges despite having a marginally smaller AQ is partly a product of a step change in transportation charges around this threshold. On 22 April 1998, Ofgas wrote to Transco requesting that it amend its charging structure so that this step change was addressed. Prices that will come into effect on 1 October 1998 reduce this step change in transportation charges.

### 3. Future Treatment of Non-Domestic sites

The modification proposes specific steps to remove from RBD all Condition 35 sites and sites inappropriately assumed to consume below 2,500 therms a year. Ofgas agrees that Transco should bring forward measures to ensure these sites are excluded from RBD in the future. One option is that, for Condition 35 sites, if IT changes to remove these site from RBD are not forthcoming from Transco, it could provide shippers with greater opportunity to revise these sites' AQs.

This has been discussed as part of Transco's proposals for the correction of inaccurate domestic AQs in 1998. Transco has recently clarified its proposals as to the opportunity it will give shippers to correct inaccurate domestic AQs. Ofgas has written to Transco raising a number of questions about its proposals and, we understand, Transco intends to circulate these questions to shippers for discussion. Transco is yet to put forward its final proposals. We envisage that the issues that are raised in Modification 226 concerning the future treatment of these sites can be taken forward as part of that work.

### Summary

In conclusion, we agree with those shippers who have suggested that it is inappropriate that I&C shippers should face increased operating costs as a result of Transco adopting RBD and not putting in place measures to avoid it inappropriately affecting I&C shippers. Were a modification proposal brought forward that satisfactorily addressed this one aspect of Modification 226, we would envisage consenting to it. However, we are not persuaded that it is appropriate to rebate transportation charges in this instance and believe Transco is already bringing forward proposals to enable shippers to increase AQs where they have been inappropriately included within the scope of RBD. Therefore, we have not consented to Modification 226, in its current form.

Yours sincerely



Sean Aldridge  
Head of Network Operations