

Direct Dial: 020-7932-5927

18 September 2000

BG Transco, Shippers and Other Interested Parties

Your Ref:

Our Ref : Net/Cod/Mod/0423

Dear Colleague,

Modification Proposal 0423 'Waiver of two-month notice period for adjustment of NTS Commodity Charge'

Ofgem has considered the issues raised in Modification Proposal 0423 '*Waiver of two-month notice period for adjustment of NTS Commodity Charge*'. Ofgem has decided to direct BG Transco to implement the modification, because we believe that this proposal will better facilitate the relevant objectives of BG Transco's Network Code.

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

Background to the proposal

Under its price control, BG Transco's is expected to earn around 5% of its target revenue from the sale of entry capacity. When NTS entry capacity auctions were first introduced in October 1999, the auction rules stipulated that any over or under recovery was to be returned / recovered through "K", the correction factor in the price control, which would lead to an increase in other transportation charges.

In the March 2000 monthly entry capacity auctions, Transco recovered £86 million in excess of its target revenue for the auctions. Due to this significant over-recovery of revenue, Transco should issue a pricing consultation, PC 53 '*NTS Entry Capacity Auction Revenue Re-Balancing*,' with a view to rebating all or a proportion of the over-recovery by 1 May 2000. Ofgem did not veto this pricing proposal and it took effect on 1 May 2000, allowing for rebates on the commodity and entry charges to return the over-recovery. However, it was recognised that a mechanism would need to be implemented to deal with any under or over recoveries in future auctions. Subsequently, Transco raised Pricing Consultation PC 60 '*Rebalancing Revenue raised by Monthly System Entry Capacity (MSEC) and other NTS Auctions*' which explored a number of options to deal with any under or over recovery of revenues arising from any product sold by auction. Such a mechanism would need to be in place to deal with the outcome of the August 2000 auctions. Following consultation, Transco proposed that any under or over recovery should be dealt with first by using the 'K' correction factor for any deviation within 10% of a target level of revenue recovery. Any additional under or over-recovery would then be dealt with by adjusting the NTS commodity charge. Ofgem decided not to veto this proposal.

The modification proposal

It is proposed that the period of notice for changes to the NTS commodity charges should be reduced from two months to one month. It is also proposed that the notice period should be waived on an exceptional basis to address any over-recovery associated with the either the

monthly entry capacity auctions or other NTS auctions for the period October 2000 to March 2001 period.

Respondents' views

Of the five respondents to the modification, two supported the proposal in full. The other three respondents only offered support for the notice period to be waived with respect to a commodity charge adjustment to be effective from 1 October 2000. These shippers did not support the permanent reduction to the required notification period for changes to the NTS commodity charge, to one month. All three shippers observed that the recent entry capacity auctions were delayed to allow further time to develop the auction regime, therefore, under normal circumstances, the auction would have been completed in July, implying that the full two months notification period could be given in the future. One shipper sought clarification regarding the forthcoming monthly interruptible auctions. They felt the proposed adjustment to the commodity charge should include an additional compensatory adjustment in anticipation of the forthcoming monthly auctions, to avoid further changes to the NTS commodity charge following the monthly auctions. They also suggest that BG Transco should indicate as quickly as possible the nature of the adjustment to the NTS commodity charge. Another shipper argued that industry should be aiming for a more stable regime where adequate time is allowed for the two-month notice period to apply. In addition they also suggest that it may be beneficial to extend the notice period for changes to transportation charges to three months, to allow customers and suppliers greater certainty over the transportation charges that will apply when tenders are being submitted and considered.

Ofgem's View

Ofgem supports this modification because it will enable Transco to implement the outcome of PC60 from 1 October 2000, as was intended when we decided not to veto PC 60. Given that the recent auctions resulted in a significant over-recovery, we believe that it is crucial that PC 60 should take effect from 1 October 2000, otherwise shippers may potentially be exposed to cash flow effects, if the implementation of this pricing consultation were to be delayed. Ofgem does not support the view that an additional compensatory adjustment should take place prior to the commencement the forthcoming monthly interruptible auctions, as the size and scope of any adjustment will depend on the outcome of these auctions. We understand respondents concerns about the use of this waiver on an exceptional basis in the future, however, we believe that it is prudent to have such flexibility in place should the need arise. Ofgem supports the objective of ensuring that in future auctions are held in sufficient time to ensure that the normal notice period for changes to the commodity charge can be adhered to.

Ofgem's Decision

Taking all the considerations above in to account, we have decided to consent to this modification, as we believe that it conforms to the relevant objectives of BG Transco's network code, in particular; the securing of effective competition between relevant shippers and relevant suppliers, because if there was to be a delay in the implementation of PC 60, shippers could be exposed to significant cash flow risks.

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,

Steve Smith

Director, Trading Arrangements