June 2002

TRANSCO CONSULTATION REPORT ON PC73

STRUCTURE OF THE NTS SO COMMODITY CHARGE

1. Transco's Initial Proposal

In PC73 Transco sought views on the proposal that the NTS SO standard commodity charge should apply to gas flows at all entry and exit points with the same rate of charge applying at both entry and exit.

This report sets out the views received and Transco's response.

2. Summary

There were 21 responses to the consultation paper.

Shippers & Suppliers	
Agip	AGP
BG Gas Services	BGGS
British Gas Trading	BGT
BP Gas Marketing	BPGM
Chevron	CHV
Conoco	CON
Dynegy	DYN
Entergy-Koch Trading	EKT
Exxon Mobil	EXM
Innogy	INN
London Electricity Group	LEG
Marathon	MAR
PowerGen	PG
Scottish Power	SP
Scottish & Southern Energy	SSE
Shell Gas Direct	SGD
Statoil	STA
TXU Europe Energy Trading	TXU
Other Interested Parties	
Association of Electricity Producers	AEP
Chemical Industries Association	CIA
Corus	COR

Eleven respondents supported the proposal, either as published or in principle but with concerns regarding its application. Nine respondents did not support the proposal. One respondent did not indicate whether they supported the general application of the proposal.

3. Detailed Responses

3.1 Cost Reflectivity

Eight respondents (AEP BGT INN LEG PG SSE SP TXU) thought that the proposal would make the transportation charging methodology more cost-reflective. However, seven respondents (AGP BGGS CON DYN MAR SGD STA) thought that no justification of the change had been made. Two respondents (AGP MAR) noted that no market participants had requested the change.

Transco's Response

Transco considers that justification, in terms of improved cost-reflectivity, for the change was made in the consultation paper, PC73. The level of the SO commodity charge relates to both the SO costs and the incentive adjustments under the proposed Licence modifications. Whilst the drivers behind these SO costs and incentive adjustments are complex, some of them, for example the capacity buy-back incentive adjustment and the use of compressor fuel, are related to entry requirements. Charging on both entry and exit flows would mean that the SO costs are reflected in the level of transportation charges for all shippers.

With regard to the comment that no market participants had requested the change, Transco observes that the majority of those responding to the consultation support implementation.

3.2 Impact on NBP and End User Prices

In PC73 it was suggested that the NBP price for gas trades would be expected to adjust for any rebalancing of the SO commodity charge between entry and exit, so that the net impact on shippers who trade at the NBP would be largely unchanged. Three respondents (CHV CON STA) thought that the NBP price would not adjust. Three respondents (AGP BGGS CON) thought the change would impact the NBP negatively. Three respondents (MAR BGGS CON) thought the change might reduce liquidity at the NBP. One respondent (BGGS) thought that, with Transco potentially involved in trading through purchasing Forwards and Options contracts and also being able to determine the timing of commodity rate changes, Transco would have an unacceptable position of influence on the NBP price.

Eight respondents (AGP BGGS BPGM CON MAR SSE SGD TXU) thought that more time was required prior to implementation of any such change to allow time for NBP and other contracts to be revisited. Similarly, three respondents (BGGS CHV CON) thought that any reduction in the level of the commodity charge at exit might not feed through to end users. One respondent (CIA) thought the potential change created further potential instability in transportation charges and thus made end user contract negotiations more difficult.

Transco's Response

Transco still considers that the NBP price for gas trades would adjust in due course. Further, with the present regime there are a number of uncertainties in the level of costs for shippers selling gas at the NBP, for example the beach cost of gas and the level of entry payments, and Transco considers that with an SO entry commodity charge the uncertainties would not be greatly increased and so would not expect any large negative impact from the change on NBP gas trading.

Transco considers that the change would be unlikely in practice to enable it to influence the NBP price in its own interest. However, were this potential influencing capability to become an issue, Transco considers that it would be best addressed by Ofgem through the terms of the Licence rather than by changing the transportation charging structure.

Transco agrees that, where there are longer-term contracts for gas trades at the NBP, the change could have a negative impact on some shippers in the short term. It is proposed therefore that the change should not be implemented until October 2003 so that, where necessary, contracts can be revisited prior to implementation.

Transco recognises that all potential changes create some uncertainty. However this potential change involves a rebalancing of the SO commodity charge and so would not generally change the level of charges incurred in transporting gas to end users

3.3 Impact on Offshore Industry

Six respondents (AGP BGGS CHV CON MAR STA) thought that the change amounted to a tax on the offshore gas industry and would also add further uncertainty to their costs. Three respondents (EXM SGD SSE) thought that greater certainty on a number of charging issues, for example neutrality and long-term capacity sales, would be beneficial.

Transco's Response

The proposal is for a rebalancing of the SO commodity charge and so would not increase the total level of charges incurred in transporting gas to end users. Since, as stated above, Transco expects that the NBP gas price would adjust in due course to the rebalancing, it is not clear that there would be a negative impact on shippers selling gas at the NBP nor, by linkage, on the offshore gas industry.

Transco recognises the desire for greater certainty over a number of charging issues and would welcome views on how this could best be achieved. However, it is the nature of the regime, where many parties can propose changes impacting on the transportation terms, that uncertainties will exist at times.

3.4 **Application of Commodity Charge at Storage Entry and Exit Points**

Nine respondents (AEP BGGS BPGM BGT DYN EKT SSE SP TXU) either felt unable to comment on the application of the charge in respect of storage entry points or thought further consultation on this aspect was needed, due to the uncertainty arising from the number of Network Code modifications at present being considered in respect of exit flows. Four respondents (BGT DYN INN LEG) thought that implementation of the change should be co-ordinated with implementation of exit charging in respect of storage points.

One respondent (DYN) considered that the detail of charging should be dealt with through Network Code modifications to enable proper debate on the appropriateness of using UDQI as the charge driver.

Transco's Response

As noted above, Transco proposes that implementation of the change should be at October 2003. This will provide time for the application of the charge at storage entry points, and any linkage to the application of the SO commodity charge at storage exit points, to be debated and resolved. However, Transco considers that the application of the SO commodity charge at storage exit points, as determined under the prevailing methodology set by PC70, should, once the method of application has been resolved, be implemented as soon as practicable.

Transco considers that the present pricing consultation process, as defined in the Gas Transporter Licence, allows shippers' and others' views to be taken into consideration and that the Network Code modification process should only be used where a change to the Network Code is required.

3.5 Interaction with the Optional NTS Commodity Charge

One respondent (SSE) asked if the optional commodity charge would continue. Other respondents thought the proposal would either erode the benefit of the optional tariff (AGP) or worsen the possible perverse incentives for short-haul transportation (MAR).

Transco's Response

The Optional NTS Commodity Charge would continue under the proposal and would, if selected, replace both the entry and exit standard commodity charges. Since this charge operates on a specified entry point to exit point basis, and since the total level of the standard commodity charge, for an entry to exit flow, is unchanged under the proposal, Transco considers that the attractiveness of the optional tariff would be unchanged from at present.

3.6 Interaction with other Transportation Charges

Six respondents (AGP BPGM CON EXM SGD SSE) asked how the change would link to the method of handling excess auction income, with two of these (AGP CON) suggesting a possible linkage of any excess to the entry commodity rate. Five respondents (AEP CON INN SSE TXU) expressed concern about the potential volatility of the commodity charge and two of these (INN SSE) enquired about whether separate neutrality arrangements would be introduced. Two respondents (AGP BGGS) thought that the change would create a link to primary bidding activity for entry capacity.

Transco's Response

The implementation of this change would not change the method of handling excess auction income, which would continue as at present, as determined by PC65 and PC67. The present neutrality arrangements will necessarily continue until a proposal to modify the existing arrangements is raised, developed and implemented. Transco would expect any impact on volatility of the commodity charge to be debated as part of the process were such a proposal to be raised.

Transco is not clear how the change would be expected to create a direct link to entry capacity bidding since the charge would be payable on entry flows rather than capacity bookings.

3.7 Implementation of Change

Four respondents (BGT SGD SSE STA) considered that more time was required for the system changes prior to implementation.

Transco's Response

The proposed implementation date of October 2003 should help to resolve any implementation resource constraints.

4. Conclusion

Transco welcomes the comments on the proposal contained within PC73. Many of the concerns raised relate to the lack of time both to revisit NBP gas trade and other contracts and also to resolve implementation issues. In the light of these concerns, Transco intends to propose implementation of the proposal from October 2003. The final proposal is otherwise unchanged from that in PC73 and is:

1. That the SO commodity charge should apply to all gas entering the gas transportation system at all system entry points as well as to all gas offtaken at exit points from the gas transportation system.

2. That the same rate of commodity charge should be applied for both entry and exit.

3. That this change should be implemented from 1 October 2003.