

## **Pricing Consultation Paper PC75**

### **NTS TO Commodity Charge**

#### **1. Introduction**

The present transportation charging methodology for explicitly handling entry capacity auction revenue in excess of the target level is defined by PC65, as amended by PC67. In summary, a credit is paid to each User in relation to their monthly MSEC holdings up to the level, in total, of the excess revenue or the aggregate User buy-back costs, whichever is the lower. Where the auction excess is greater than the aggregate User buy-back costs then Transco may adjust other transportation charges so as to aim to not over-recover against its maximum allowable revenue.

Under the proposed new regulatory framework expected to be applicable from April 2002 there will be separate limits on the maximum NTS TO, NTS SO and LDZ revenue. The flexibility for adjustments to other transportation charges in response to higher than target levels of entry capacity auction revenue is thus limited to NTS exit capacity charge adjustments.

This paper describes a possible change to the transportation charging methodology in which an NTS TO commodity charge would be created. If the TO revenue obtained from the other charges were in line with target levels then it would be expected that the NTS TO commodity charge would be zero. If the TO revenue was out of line with the target level, due to entry auction revenue levels or other factors, then the NTS TO commodity charge could be adjusted downwards (so as to be negative) or upwards so as to aim to not over-recover against the maximum allowable TO revenue. This methodology could either supercede or complement that established by PC65.

#### **2. Discussion**

Under the proposed regulatory framework and with the existing transportation charging methodology, Transco will ultimately be able to adjust only the NTS exit capacity charges in response to a large excess of TO entry capacity auction revenue above target. A drawback of such reductions to the exit capacity charges would be that the adjustment would impact solely on firm transportation charges and would reduce the differential between firm and interruptible transportation charges. The level of excess revenue that could be handled through this adjustment would also be limited to the revenue level expected to be raised by the exit capacity charges for the remainder of the formula year within which the change was made.

In addition, the Ofgem proposed SO incentive scheme provides Transco with an incentive to reduce the level of exit revenue foregone in respect of interruptible supply points against a target revenue level based upon the then prevailing level of exit capacity charges. Reducing

the exit capacity charges in response to a high level of excess TO entry auction revenue might be considered to be an inappropriate means of possibly out-performing against this target.

If a NTS TO commodity charge were to be introduced then the level of this charge could be adjusted in the light of excess TO entry auction revenue either:

- (a) In place of the existing PC65 methodology; or
- (b) In addition to the existing PC65 methodology, if the level of excess revenue were to be greater than expected to be handled by the PC65 methodology.

The possible advantage of the NTS TO commodity charge adjustment replacing the existing PC65 methodology is that it would break the linkage between the adjustment and entry capacity holdings. It would also result in a single adjustment mechanism, whereas if PC65 is retained the split of revenue adjustment between the two mechanisms would be uncertain. However, applying a commodity charge adjustment only after a PC65 adjustment would enable a potentially greater level of excess auction revenue to be handled and could reduce the need for a negative TO commodity charge in some circumstances. If the PC65 methodology is retained then it may be desirable to change the charge driver to reflect any Network Code change to the capacity buy-back cost apportionment driver, so as to retain equivalence of costs and entry charge adjustments.

In any event, it is envisaged that the maximum negative NTS TO commodity charge rate set would be such that, in combination with the NTS SO commodity charge, the combined effective NTS commodity charge rate would not be lower than the short-run marginal cost of operating the NTS system.

The introduction of a TO commodity charge would enable the TO commodity charge to be set to allow for any forecast TO over- or under-recovery. For example, the present PC65 methodology does not operate unless the excess revenue is in excess of 10% over target. However, based on Ofgem's draft GT Licence modification proposals, 10% auction excess would lead to potentially significant TO over-recovery. Adjustment of the TO commodity charge downwards could help to offset such an outcome. Similarly, if there were forecast TO under-recovery, due to the entry capacity auction outcome or other cause, then a positive TO commodity rate could offset this.

It is proposed that the TO commodity charge would be applied on an identical basis to the SO commodity charge, namely on an exit-only basis initially but on an entry and exit flow basis, with the same unit rate for entry and exit, from October 2003 if PC73 is implemented.

It is suggested that implementation of the TO commodity charge, if proposed following consultation, should be as soon as practicable in order to give the maximum time for a non-zero TO commodity charge to be effective within the present formula year, if necessary following the auction of winter MSEC. This is likely to be November or December 2002.

Transco's initial view is that no Network Code modification is necessary to enable the introduction of a NTS TO commodity charge.

### **3. Indicative Charge Level**

On the assumption that the excess auction revenue from the previous MSEC auction is offset by the entry charge credits determined by the PC65 methodology and that the auction revenue from the next MSEC auction is in line with the target revenue level, the indicative level of the NTS TO commodity charge, were it to be implemented, is zero.

### **4. Questions for Consultation**

**Transco seeks views on the following proposed changes to its Transportation Charging Methodology:**

- **That a NTS TO commodity charge be introduced, additional to the NTS SO commodity charge;**
- **That the level of the NTS TO commodity charge should be zero if the forecast other TO revenue is in line with target revenue levels;**
- **That Transco should set the level of the NTS TO commodity charge to adjust, if necessary, the forecast level of TO revenue if there is forecast to be over- or under-recovery of TO revenue against the maximum allowable TO revenue;**
- **That adjustment to the NTS TO commodity charge relating to any excess of NTS entry capacity auction income against target should supercede the adjustment methodology established by PC65. Views on an alternative methodology, that the PC65 methodology be retained with any NTS TO commodity charge adjustment made after a possible PC65 methodology adjustment, would also be welcome;**
- **That the NTS TO commodity charge should have an identical structure at all times to the NTS SO commodity charge and that the minimum negative NTS TO commodity charge should be such that, in combination with the NTS SO commodity rate, the combined effective NTS commodity rate should not be lower than the short-run marginal cost of operating the NTS system.**