# Modification Report
# Structure of the NTS SO Commodity Charge
# Modification Reference Number 0626

Version 2.0

This Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

## 1. The Modification Proposal

It is proposed that the NTS SO Commodity Charge, which is currently calculated by applying the NTS SO Commodity Charge rate to daily offtake quantities, be calculated by applying a revised NTS SO Commodity Charge rate to both daily input and offtake quantities.

The NTS Commodity Charge for each User would be the sum of the NTS Entry Commodity Charge and the NTS Exit Commodity Charge; where

NTS Entry Commodity Charge = NTS Entry allocated quantities x NTS Commodity Charge Rate
NTS Exit Commodity Charge = NTS Exit allocated quantities x NTS Commodity Charge Rate.

The proposed charges would, with the exception of Storage Connection Points, apply to all NTS exit and entry points. Consistent with the PC73 methodology, it is anticipated that a common commodity charge rate will be applied to both Entry and Exit allocated quantities.

In respect of Storage Connection Points, it is proposed that there should be no change to the existing approach such that an NTS Commodity Charge would apply solely to exit flows associated with Own-Use Gas consumed at the respective Storage Facility. It is intended that the extension of the NTS SO Commodity Charge to other flows associated with Storage Connection Points would be determined subsequently to satisfy the requirements of the PC70 Pricing Methodology.

## 2. Transco's Opinion

Having carefully considered the views and arguments raised by repondents in the consultation process associated with this Proposal Transco has decided that whilst the merits and disadvantages of implementation of this Proposal are finely balanced that, at this point in time, Transco does not recommend implementation.

Pricing Consultation PC73 "Structure of the NTS SO Commodity Charge" proposed that the NTS SO Commodity Charge would be applied to all gas entering the gas transportation system at System Entry Points, as well as to gas exiting the gas transportation system at System Exit Points, with effect from 1 October 2003. Following Ofgem's decision on 30 July 2002 not to veto PC73, the charging methodology proposed in PC73 will become effective should this Proposal be implemented.

Should implementation be directed, Transco proposes a pragmatic approach to the implementation of the charging methodology proposed in PC73 but recognises that there are other related issues which may subsequently need to be considered. The Proposal specifically excludes application of the revised charges to storage flows as envisaged in PC70 "NTS System Operation Transportation Charges". Transco considers that, in light of Ofgem's decision letter in respect of Modfication Proposal 0532 "Application of SO Commodity Charges to all NTS loads", it is unlikely that a suitable charging solution for storage flows could be developed sufficiently quickly to facilitate implementation within the timescales envisaged in PC73. Transco is also of the view that the impact of applying the NTS SO Commodity Charge to entry flows on the level of SO Commodity Charge is far greater than the impact of including storage flows. In a note to the Network Code Modification Panel, Transco indicated that, whilst the application of the NTS SO Commodity Charge to entry flows would be likely to reduce the NTS SO Commodity Charge rate by approximately 50%, the application to the Storage Connection Point flows would be likely to have less than a 2% further impact. Transco therefore suggests that it may appropriate to consider whether the charging for entry flows should be considered as a priority.

In parallel with the developments on the structure of the NTS SO Commodity Charge, the issue of recovery of the NTS TO Revenue has been considered in the Pricing Discussion Paper PD17 "Setting of the NTS Transportation Charges". Transco has issued the Discussion Report on PD17 and this will be followed by an appropriate Pricing Consultation Paper.

Should the Proposal be implemented, the NTS SO Commodity Charge revenues would be recovered by the application of charges to both entry flows and exit flows such that approximately half of the revenue is recovered from entry flows and approximately half from exit flows. This would be achieved by the application of a single Applicable Commodity Rate that would be applied to gas flows at entry and exit points of the system. The NTS Optional Commodity Rate would, however, continue to be applied in respect of System Points electing the optional NTS commodity tariff; such System Points would continue to attract the NTS Optional Commodity Rate but would not attract the new NTS Entry Commodity Charge in respect of relevant inputs at the local System Entry Point. Transco believes that levying the NTS Entry Commodity Charge, in addition to applying the NTS Optional Commodity Rate, is not consistent with the principle underlying the introduction of the NTS Optional Commodity Rate; the optional NTS commodity tariff is intended to provide economic incentives for Users to use the NTS rather than build dedicated pipelines bypassing the NTS.

The Proposal, if implemented, would result in an amendment to the Commodity Charge invoicing. The 'NTS Commodity Charges' would consist of 'NTS Entry Commodity Charges', 'NTS Exit Commodity Charges' and 'NTS Optional Commodity Charges'. A key issue is the availability of data to permit timely billing of the charges; exit quantities are available after D+5 whereas entry quantities are not available until after M+15. An objective of the invoicing process is to optimise delays in billing, taking account of the system and administrative workload associated with the billing process. Transco has considered a number of options which vary from submission of the charges immediately after close-out of UDQOs and carrying out appropriate adjustments after close-out of UDQIs to the submission of all charges after close-out of UDQIs. Transco has concluded that any processes involving estimations and subsequent adjustments would generate unwarranted complexity in the billing and subsequent reconciliation process. Therefore, Transco advocates that the charges are invoiced, as soon as reasonably practical, after the relevant information to enable the billing process becomes available; the NTS Exit Commodity Charges would therefore be invoiced after close-out of UDQOs, the NTS Entry Commodity Charges after close-out of UDQIs, and the NTS Optional Commodity Charges, which require validation against UDQIs, after close-out of UDQIs. Whilst this option would result in delayed invoicing for recovery of approximately half of the NTS SO Commodity Charge revenues (a loss of around £200k per annum to Transco through loss of interest), Transco considers that this would be the preferred option should the Proposal be implemented.

Transco has carefully considered the views expressed by shippers, gathered as a result of the consultation about this Proposal. Transco believes that the costs and benefits, which might be associated with implementation of this Proposal, are finely balanced. On the one hand, implementation of the Proposal would be consistent with an early implementation of PC73. However, implementation of the Proposal would generate administrative and systems costs for both Users and Transco. Additionally, Transco believes that implementation of the Proposal might have some adverse consequences identified by respondents to this consultation. Overall Transco concludes that, whilst these considerations are finely balanced, that at this point in time Transco recommends that the Proposal should not be implemented.

Transco considers that, should Ofgem elect not to direct implementation of the Proposal, it may be appropriate to reconsider the issue of the basis of the SO Commodity Charge in the context of its application to both entry and storage flows in a further Pricing Consultation process.

Transco therefore does not recommend implementation of the Proposal.

Transco is not aware of any direct implications that would arise in the electricity regime, should this Proposal be implemented.

## 3. Extent to which the proposed modification would better facilitate the relevant objectives

Implementation of the Proposal would enable implementation of charges in accordance with the methodology established by PC73. This methodology was established with the intent of improved cost-reflectivity which might be consistent with the objectives in Standard Condition 4(5)(a) of Transco's GT Licence i.e. the development of a Transportation Charging Methodology that reflect the costs incurred by Transco in its transportation business. Implementation of the Proposal might therefore better facilitate the relevant objective of efficient discharge of Transco's obligations under its licence, as stated in paragraph 1 of Standard Condition 9.

## 4. The implications for Transco of implementing the Modification Proposal , including

### a) implications for the operation of the System:

It is not considered that implementation of the Proposal would have any material impact on the operation of the system.

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

Transco would incur additional costs in the development, maintenance and administration of the billing systems and processes. The optional NTS commodity tariff would remain unchanged; the systems would ensure that, where NTS SO Optional Commodity Rate is applicable, Users would not pay the normal NTS SO Commodity Charge associated with relevant inputs at the local terminal. Separate invoices would be submitted for NTS Entry Commodity Charges (new invoice), NTS Exit Commodity Charges (amendment to the current Commodity Invoice), and for charges based on the NTS Optional Commodity Rate (new invoice). The amended Commodity Invoice would be submitted on M+8 (as is currently the case) and the new invoices would be submitted on M+18. Indicative system development costs for invoicing (around £150k) and modifications to the off line systems (around £50k) suggest that the total system implementation costs are around £200k (assuming that the changes are implemented as part of the Gemini system release that is expected to be implemented to take effect from Gas Day 1st November 2003).

Transco currently submits the Commodity Invoice, which includes NTS Transportation Charges, on M+8. Since nearly half of the NTS Transportation Charges would be submitted via the NTS Entry Commodity Invoice on M+18, Transco would incur loss of interest due to delayed submission of the NTS Entry Commodity Invoice. The annual loss of interest from the reduced cashflows is estimated at approximately £200k. There would also be a modest impact of delayed invoicing and earlier collection of adjustment amounts associated with the optional NTS commodity tariffs, resulting in the net impact being negligible.

Introduction of an NTS Entry Commodity Charge might be expected to increase NBP gas prices, and hence gas purchases at NBP for Shrinkage and Operating Margins purposes might influence Transco's performance under the gas cost incentive.

### 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:

Any associated operating and system development costs would contribute to the SO internal costs, and would therefore be distributed between Transco and Users in accordance with the internal costs incentive.

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

No consequences are envisaged on price regulation.

## 5. 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

No consequences are envisaged on the level of contractual risk to Transco.

## 6. The development implications and other implications for computer systems of Transco and related computer systems of Users

Transco currently submits the Commodity Invoice at M+8. The invoice includes both the NTS Commodity Charges based on the 'standard' Applicable Commodity Rate and those based on the NTS Optional Commodity Rate. Any adjustments as a consequence of applying the 'eligibility criterion' for the NTS Optional Commodity Rate are made later.

The Proposal, if implemented, would lead to an amendment to the Commodity Invoice such that it would only include the NTS Exit Commodity Charges; the charges arising from application of the NTS Optional Commodity Rate would be excluded. There would be no change to the timing of the submission of the amended invoice.

The NTS Entry Commodity Charges would be submitted via a new invoice (NTS Entry Commodity Invoice) on M+18.

With regard to the charges based on the NTS Optional Commodity Rate, a new invoice (NTS Optional Commodity Invoice) would be submitted, also on M+18. Submission of the NTS Optional Commodity Invoice after close-out of UDQIs would ensure that the 'eligibility criterion' could be applied after close-out of entry allocations, and would remove the need to make any adjustments later as is currently the case.

Amendment to the current Commodity Invoice would lead to a change in the invoicing file format, and the creation of the two new invoices would lead to two new file formats. Transco envisages that the IT systems of the Users might need to be amended to cater for these changes.

## 7. The implications of implementing the Modification Proposal for Users

The recovery of NTS SO Commodity Charge revenues will be split between the Commodity Invoice (amended to include NTS Exit Commodity Charges) and an NTS Entry Commodity Invoice. Because of the differences in close-outs for entry and exit allocations, these invoices will be submitted separately. The amended Commodity Invoice will be issued on M+8 in the month following gas flow, as is currently the case, and the NTS Entry Commodity Invoice will be issued on around M+18 in the month following gas flow. The NTS Optional Commodity Invoice will also be submitted around the same time as the NTS Entry Commodity Invoice, and will include adjustment to the charges based on the NTS Optional Commodity Rate for any over charging on the NTS Entry Commodity Invoice.

Since most entry flows, which are currently exempt from any Commodity Charges, will attract the NTS SO Entry Commodity Charge, implementation of the Proposal could introduce extra uncertainty in the NBP gas price which might result from the additional risk premia that might be associated with physical gas deliveries onto the system.

## 8. The implications of implementing the Modification Proposal for Terminal Operators,Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

Most entry flows, which are currently exempt from any Commodity Charges, will attract the NTS SO Entry Commodity Charge. The proposed charge on entry flows could contribute to the cost of delivering gas onto the system and hence could have an impact on producers depending on the commercial arrangements they have, or might use, that enable them to bring gas to the beach or ensure it is available at the NBP.

## 9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

Transco is not aware of any such consequences.

## 10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantage:

- Achieves consistency with PC73;

Disadvantage:

- Requires two additional invoices and amendment to an existing one;
- May create extra uncertainty in respect of NBP gas prices, particularly for those trading forward at the NBP and expecting to deliver gas at the input to the system.

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

Representations were received from the following twelve parties:

| **Respondent** | **Response** |
|---|---|
| Powergen | For |
| Association of Electricity Producers (AEP) | For |
| ConocoPhillips | Comments |
| Marathon Oil | Against |
| Innogy | Qualified support |
| Statoil | Against |
| Agip (ENI) | Against |
| London Electricity Group (LEG) | For |
| Scottish Power | For |
| Scottish and Southern Energy (SSE) | For |
| BG | Against |
| British Gas Trading (BGT) | Qualified support |

**Summary**

| | |
|---|---|
| For | 5 |
| Against | 4 |
| Qualified support | 2 |
| Comments | 1 |

## Cost Reflective Charging Methodology

AEP stated that "the application of SO commodity charges to both entry and exit flows will implement the intent of PC73, result in more cost reflective charges and provide for consistency with BSUoS charges in electricity".

Powergen believed that the Proposal "will benefit the competitiveness of the gas regime by being more cost reflective, as there will be a more equal distribution of the charges across all parties active in buying and selling gas both at the beach and at the NBP". Powergen also believed that the Proposal "will enable the implementation of PC73", and "was not vetoed by Ofgem".

Marathon was "unsure of your rationale that the proposal would better reflect costs". In its opinion, the "original justification for confining commodity costs to shippers moving gas from NBP to exit point" was that "most of the costs occur at the NTS offtake and metering points" and questioned why this rationale is no longer valid.

Scottish Power believed that the implementation of charges proposed in PC73 was less complicated and more cost reflective than the storage charges envisaged under PC70, and hence the Proposal should be implemented on the proposed target date.

SSE believed that the application of SO commodity charges to both entry and exit flows was consistent with the pricing methodology established in PC73 and would "result in more cost reflective charging".

LEG considered that the Proposal "will introduce more cost reflective charging into the Transportation costs". Whilst acknowledging cost reflectivity, LEG questioned whether Transco would be able to recover the target level of revenues, given the forecasting errors in the determination of the charge level, or whether "the SO Commodity charge might change dramatically and erratically in future to reflect any over/under recoveries which is something that Shippers and Transco agreed would not be in the industry's best interest".

BGT stated that it supported the principle of applying charges to both entry and exit flows as it did "improve the cost reflectivity of charges applied". However, it expressed "some concerns that related matters [entry and exit based charging, storage flow charges, TO charging and Optional Commodity Tariff], have not been addressed in order to coordinate implementation of the necessary changes in a more logical ways", and believed that a "single exercise" would "avoid the uncertainty associated with multiple system charges and variations in pricing required that would be an inevitable consequence of piecemeal implementation".

**Transco's Opinion**

In Transco Consultation Report on PC73, Transco stated that "charging on both entry and exit flows would mean that the SO costs are reflected in the level of transportation charges for all shippers". Whilst the proposed charges may lead to a more equitable redistribution of SO costs between entry and exit, Transco is less clear about the proposed charges being reflective of the costs incurred by Transco in its Transportation business, as stated in Standard Condition 4A(5)(a).

Transco believes that, in aggregate, the daily input quantities are approximately equal to the daily offtake quantities and that it is reasonable to levy the same level of charge rate on both the input and offtake quantities. Since the proposed charge is based on the gas flows, rather than the complexity or number of meter points at entry and exit, Transco sees no reason for levying different levels of charges on entry and exit gas flows.

Both the current and the proposed charging methodologies utilise forecast gas flows in the determination of the charge level. Transco does not believe that the Proposal, if implemented, would lead to any more variations in the under or over recovery of the revenues as a result of the use of forecast gas flows.

Transco recognises that there are several related issues surrounding the commodity charging, as pointed out by BGT. Transco believes that, should implementation be required before the end of the 2003 calendar year, it would not be possible to consider all the issues simultaneously. Transco has therefore adopted a pragmatic approach should the benefits of the Proposal be considered sufficient to warrant such early implementation.

**Impact on NBP Gas Prices**

Scottish Power believed that the effect of any uncertainty in respect of gas prices at the NBP should be minimal.

ENI saw "no business justification for the proposed change to the transportation charging structure" and believed that levying a further charge on market participants would add unnecessary complexity to the charging regime and would impact trading on the NBP. It believed that the proposed charge would increase the cost of delivering gas to the NBP.

BG expressed concerns about Transco's ability to influence NBP gas prices by varying the 50:50 split for entry and exit-based charges, particularly in light of "Ofgem's desire for Transco to take an active role in procuring flexibility to manage the System requirements and supposed link to the value of gas at the NBP". BG believed that the uncertainty and price curve volatility created by the proposed charge would undermine "a reliable set of pricing indicators (indices) ['Heren', 'Argus', 'IPE' and 'Spectron'] that are becoming increasing used to price gas contracts".

**Transco's Opinion**

Transco agrees with ENI that the possible introduction of the NTS SO Entry Commodity Charge might be expected to increase the cost of delivering gas to the NBP. In an efficient market, this increase in cost should be accompanied by a reduction in the cost for delivering the gas from the NBP to the customer, such that the total cost of bringing the gas onto the system and delivering it to the customer may not be significantly different from the present level of such cost. However, Transco notes that the shippers, who will bring gas onto the system in the future to support forward NBP trade commitments, might be exposed to an unexpected charge.

With regard to Transco being able to vary the "50:50 split" and thus influence the NBP gas prices, Transco believes that such a change would require a Modification to the Network Code, and that robust processes are in place to ensure proper governance of any changes to the Code.

**Response to PC73**

Marathon repeated its comments in response to PC73 and expressed disappointment that its concerns were not noted by Ofgem and Transco.

ConocoPhillips repeated its comments in response to PC73 and expressed disappointment that its comments were not considered by Ofgem and Transco.

Statoil referred to its response to PC73 and stated that it neither supported PC73 nor the Proposal.

BG noted in its response to PC73 consultation, that "in PC70, Transco did not support the application of the SO Commodity Charge on entry flows" and stated that "there has not been a sound justification of why a change is required now".

**Transco's Opinion**

In Consultation Report on PC70, Transco stated that "While Transco accepts that charging on the basis of both entry and exit may be appropriate, but considers that the cost and complexity of charging on entry and exit flows outweigh any benefits in the short term". Subsequently, Transco sought shipper views on the application of the commodity charges to both entry and exit gas flows, and raised Pricing Consultation Paper PC73. In PC73, Transco outlined the benefits of levying charges on both the entry and exit flows. Having had a further opportunity to consider this issue in the light of responses received in the Network Code Modification Proposal 0626 consultation process Transco considers that the merits and disadvantages of the Proposal appear to be very closely balanced. Transco therefore concludes that the benefits of implementation of the Proposal may well not exceed the costs and hence Transco advocates that this Proposal should not be implemented.

## Impact on Producers

Marathon noted Transco's statement that "Transco is not aware of implications of implementing the Proposal.... for Producers" but stressed that the new, unforeseen charge would have significant implications for "our gas transportation costs".

ConocoPhillips expressed "bewilderment" that Transco is not aware of implications of implementing the Proposal for the Producers. It considered the proposed charge to be a "material new and variable charge for gas entering the UK onshore transmission grid from offshore fields and imports", and requested an explanation for the rationale for Transco's statement. ConocoPhillips believed that the proposed charge "represents a recurring multi-million pound extra charge for ConocoPhillips" and would similarly affect other gas producers, with implications for offshore field operations and knock-on effect for the UK.

Statoil stated that implementation of the Proposal would "heavily" impact the upstream industry, in particular the producer-shippers delivering gas to the system. Statoil was unclear to the need for the proposed charges as it would not change Transco's overall revenue position but was concerned about the impact of further uncertainty should the 50:50 entry/exit charge split change in the future.

ENI believed that the "charge will fall heavily on the upstream industry" and "will have a negative effect on the economics of developing smaller gas fields in the North Sea", which "could be detrimental to the UK's security of supply".

BG believed that the "Modification represents a further tax on the upstream community", and did not believe that this "additional cost will be passed on through NBP prices". It also believed that "substantial quantities of gas are still bought and sold under Supply Contracts that extend well past October 2003 and the sellers will be left bearing the increased costs". BG stated that, "notwithstanding the fundamental flaws of the Modification.... we suggest that any implementation date is no earlier than 1 October 2005".

### Transco's Opinion

Transco has stated in the Proposal that the proposed charging methodology is intended to recover the same level of revenue as is the case under the present arrangements. However, the distribution of charges among shippers would be different.

The driver for the proposed charges is the gas flows at entry and exit which are approximately equal. Transco considers that, should the Proposal require implementation, it is reasonable to levy the same level of charge on both the input and offtake quantities. Any change to the "50:50" entry/exit split would need to go through appropriate consultation and governance process.

Transco disputes that this Proposal, if implemented, could be detrimental to the UK's security of supply. New developments seeking to extract gas for sale at the NBP will recognise the incremental cost, which is simply a splitting of the Commodity Charge which would otherwise be levied on exit flows only. Transco therefore believes that the application of the NTS SO Commodity Charge to entry flows would not distort the price of gas to end consumers nor should it affect the profitability of producers.

Transco notes BG's suggestion for a delay to the proposed implementation date of 1 October 2003. Whilst the initial implementation date of 1 October 2002 has already been delayed, Transco does recognise the concerns of BG. However, the possibility of charging the SO Commodity Charge to entry flows has been known for a considerable period of time and hence this risk might have been considered in the context of whether to make beach or NBP sales. Transco recognises that implementation of the Proposal would increase the cost for those producers/shippers committed to delivering gas to the NBP. If this Proposal is not implemented and Transco raises another Pricing Consultation, this might afford an opportunity to reconsider whether this is a material issue in the context of the debate about the nature of SO commodity charging.

## Impact on Consumer Charges

Statoil believed that the costs associated with the proposed regulatory changes would "affect the prices which the end consumers will be charged at", and that the shippers might pass these costs to the consumers.

ConocoPhillips questioned the benefits of better cost targeting to the consumer and pointed out that "there are recent incidences in both gas a power where falls in the commodity price and related transportation/transmission charges have not been passed to the consumers".

BG believed that the transparency and cost targeting provided by existing arrangements (publication of the SO Commodity Charge and passing on in full to the end user) would be replaced by uncertainty associated with the level of entry and exit-based charges in the forthcoming periods. BG did not believe that the consumers would benefit under new arrangements, and could in fact be worse off if the NBP prices were to incorporate the charge. BG concluded that the supplier "sector will be the primary winner" as the savings would not be passed on immediately to their customers.

### Transco's Opinion

Implementation of the Proposal would rebalance the recovery of NTS SO Commodity Charges, changing the recovery from an exit-based approach to one based on recoveringthe NTS SO Commodity Charge over both entry and exit flows. Therefore, Transco would not expect any increase in charges for the end users over a sufficiently long timescale. Transco accepts that this rebalancing may not materialise in the short term and that, if this Proposal is implemented, then this may place additional exposure on those having to bring gas onto the system that had not anticipated the risk of the introduction of an SO Commodity Charge being applied to entry flows.

## System Development and Invoicing

Statoil expressed concerns about the increase in system development costs for the shippers, particularly at a time of costly changes to IT systems for the separation of metering and transportation business, and the creation of two new invoices with new file formats as well as an amendment to an existing invoice.

BG considered that "the additional systems and billing costs are modest, but unnecessary" whilst "interest loss on delayed cashflow is quite substantial". BG believes that "these costs as a proportion of the Internal Costs incentive are high for no overall benefit to transportation revenue recovery" and expressed surprise that Transco still wished to pursue the Proposal.

LEG agreed with Transco's recommendation that "the late invoicing of UDQIs (User Daily Quantity Input) is the most efficient and pragmatic way forward so as to avoid any unnecessary recalculations and rebates". LEG believed that the loss of interest to Transco due to delayed invoicing would be counter balanced by avoiding administrative costs associated with charge recalculations and invoice adjustment processes.

**Transco's Opinion**

In section 2, Transco explained that, whilst the proposed solution involved creation of two new invoices and a loss of interest to Transco due to delayed invoicing, the approach adopted by Transco was pragmatic and that the other alternatives were considered either too complex or could not be delivered in time to satisfy the requirements of a 2003 implementation date. Given the complexity associated with the invoicing processing Transco would not consider it appropriate to contemplate implementation prior to the expected implementation of the first phase of the Gemini project which is currently anticipated to be effective from the 1st November 2003 Gas Day.

Transco notes the BG comment that the costs to Transco of implementing the Proposal are substantial. However, Transco considers that it has raised the Proposal to facilitate implementation of PC73 and hence better facilitate the relevant objective of efficient discharge of Transco's obligations under its licence, as stated in paragraph 1 of Standard Condition 9.

Transco believes that there are cost implications for shippers as they may have to accommodate and process new invoices by modifying their IT systems. Transco believes that these cost/benefit trade-offs need to be considered in the implementation decision. After considering shipper responses, Transco has concluded that the costs to both shippers and Transco are likely to outweigh the benefits, and that it may not be appropriate to implement the Proposal.

**Storage Flows**

AEP expressed concerns over "the limited progress being made with respect to SO commodity charges at storage sites" and "cross-subsidy and discrimination between different types of system users". It noted that "full, non-discounted BSUoS charges are paid at Dinorwig which effectively provides for storage of electricity". AEP also expressed concerns over the governance process and a failure to implement PC70, 16 months after Ofgem's decision not to veto PC70.

Innogy expressed disappointment that "further progress has not been made in developing a mechanism to apply the charges to storage flows".

SSE noted that, with respect to storage facilities, "there is to be no change to existing arrangement" and application of commodity charges to storage flows are to be addressed separately, as soon as practical.

LEG "hope that a realistic and pragmatic route is found going forward to address these [storage flows] issues, particularly as Ofgem has rejected the last 3 modifications, namely 532, 545 and 547". LEG believed that the storage facilities should be exempt from a Commodity Charge because these facilities provided benefits in balancing the NTS at low cost. LEG expressed "concerns over the governance of Pricing Methodologies and the time taken in implementation" but noted that implementation of PC73 "was delayed due to the concerns of several Shippers surrounding the tight timescales. LEG suggested that, should Ofgem decide not to direct implementation of the Proposal, it should provide a timely response so that there is sufficient time to raise and implement a similar proposal by October 2003.

BGT stated that, although Ofgem rejected Modification Proposal 0532, "many of the issues around the application of a commodity charge to gas flows into storage facilities appeared to have been resolved" and that, "Ofgem accepted the principle that the charge should be levied on net daily physical flows, which had been the subject of the industry discussions". BGT also cited Ofgem's views that storage flows should not "bear an unreasonable share of overheads" and concluded that the issue of storage flows "could have, and should have, been addressed in a common time-frame".

**Transco's Opinion**

Transco notes that Ofgem decided not to veto PC70 in its decision letter of 18 January 2002 and that Transco raised Modification Proposal 0532 on 24 February 2002 to implement the storage flow aspects of PC70 by 1 April 2002. Transco raised Modification Proposal 0532 in a timely manner in order to ensure speedy implementation of storage flow element of PC70.

Transco also notes that, subsequently, shippers raised Modification Proposals 0545 and 0547). These Proposals and Transco's Proposal were rejected by Ofgem as none were considered to better facilitate the relevant objectives.

Transco believes that the charging methodology for storage flows has not been fully developed and that it may be necessary to consult Shippers via a Pricing Consultation Paper that specifically addresses the issue of charge application to storage flows. Should Ofgem choose not to direct implementation of the Proposal, it may be appropriate to consider a Pricing Consultation that covers both the storage flows and the entry flows.

## TO Commodity Charge

Marathon expressed concerns over another new charge on the horizon and concluded that the two new charges would have a negative effect on investment decisions in future marginal fields in the UKCS.

ConocoPhillips noted that "a further new charge, the TO Commodity Charge, is on its way" and that the additional costs for producers would present further hurdles for production and development of reserves in the North Sea, just at a time when the industry is trying to lower the costs and extend the life of mature fields.

Statoil believed that implementation of the Proposal should be delayed until the outcome of PD17 (The Setting of NTS Transportation Charges) is known.

BGT believed that "the introduction of a charge related to the over or under recovery of allowed revenue for the TO should also be addressed at the same time if this is to be applied as a commodity charge".

### Transco's Opinion

Transco has recently published the Discussion Report on PD17 and will issue an appropriate Consultation Paper in due course. Transco believes that the purpose of a TO-related commodity charge is to ensure that any over and under recovery of revenues from entry capacity auctions is managed appropriately, rather than to impose additional costs on any particular industry sector.

## NTS Optional Commodity Charge

Innogy stated that "the NTS Optional commodity rate should be maintained in the format suggested by Transco".

Statoil noted that the NTS Optional Commodity Rate was discussed under Modification Proposal 0600 (Amendment to Optional NTS Commodity Rate) which was rejected by Ofgem, but acknowledging that the issue needed to be addressed in the near future. Statoil believed that the issue of Optional Commodity Rate should be resolved prior to the implementation of the Proposal, and stressed that a piecemeal approach to changes in transportation charges should be avoided.

ENI supported "the principle that those Users electing to use the Optional Commodity Rate would continue to benefit from the reduced charge and would not attract the new Entry Commodity Charge".

BGT believed that "the implementation of the modification proposal would render the current arrangements for the NTS Optional Commodity Charge unworkable unless there is specific provision for the avoidance of both Entry and Exit Commodity Charges by electing to pay an optional charge".

**Transco's Opinion**

Transco believes that the NTS Optional Commodity Rate should continue to be applied in respect of System Points electing the optional NTS commodity tariff, such that these System Points would not attract the new NTS Entry Commodity Charge in respect of relevant inputs at the local System Entry Point. Transco believes that levying the NTS Entry Commodity Charge, in addition to applying the NTS Optional Commodity Rate, is not consistent with the principle underlying the introduction of the NTS Optional Commodity Rate, which was intended to provide economic incentives for Users to use the NTS rather than build dedicated pipelines bypassing the NTS.

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

This Proposal is not required to facilitate compliance with safety or other legislation.

**13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence**

Implementation of the Proposal would enable the timely implementation of Pricing Consultation PC73.

**14. Programme of works required as a consequence of implementing the ModificationProposal**

The main activities in developing and modifying computer systems are:

- Business Requirements Approval
- System Design & Development
- System Testing
- User Acceptance Testing

**15. Proposed implementation timetable (including timetable for any necessary information systems changes)**

Indicative timescales for system development and implementation are given below (should Ofgem elect to direct implementation).

| **Activity** | **Completion Date** |
|---|---|
| Business Requirements Approval | 16/05/03 |
| System Design & Development | 18/08/03 |
| System Testing | 12/09/03 |
| User Acceptance Testing | 10/10/03 |
| Implementation | 01/11/03 |

Work is continuing to ensure that this timetable, which is consistent with a 1 November

2003 implementation of PC73, can be delivered. However, an early decision on this Proposal would be of benefit to both Transco and the community. If the recommendation not to implement is accepted, then the above timetable will be aborted. The earlier such a decision is reached, then the smaller any wasted costs which would otherwise accrue to both Transco and Users. Whilst it might be feasible to contemplate an earlier implementation Transco would not advocate such an approach given that any earlier implementation, for example 1st October 2003 (as originally proposed), would necessitate considerable expenditure to support manual workarounds and ad-hoc billing processes to support the invoicing of the charges resulting from implementation of this Proposal.

## 16. Recommendation concerning the implementation of the Modification Proposal

Transco does not recommend implementation of the Proposal.

## 17. Restrictive Trade Practices Act

If implemented this proposal will constitute an amendment to the Network Code. Accordingly the proposal is subject to the Suspense Clause set out in the attached Annex.

## 18. Transco's Proposal

This Modification Report contains Transco's proposal not to modify the Network Code and Transco now seeks agreement from the Gas & Electricity Markets Authority in accordance with this report.

## 19. Text

### SECTION B: SYSTEM USE AND CAPACITY

Amend title of paragraph 2.11 to,

"Entry Charges, NTS Entry Commodity Charges and Capacity Surrender Charges."

Amend paragraph 2.11.1 to read,

"2.11.1

(i) A User shall pay Capacity Charges (**"System Entry Capacity Charges"**) in respect of its Registered System Entry Capacity at Aggregate System Entry Points, and

(ii) Commodity Charges (**"NTS Entry Commodity Charges"**), in respect of the flow of gas into the NTS on any day, or a charge calculated by reference to Special Condition [28B] of the Transco Licence."

Renumber existing paragraph 2.11.6 as 2.11.7; Insert new paragraph 2.11.6,

"2.11.6 The NTS Entry Commodity Charge payable by a User in respect of each Day will be determined for each NTS Entry Point as the User Daily Quantity Input less any quantity to which the NTS Optional Commodity Rate applies in accordance with Code multiplied by the Applicable Commodity Rate for such Commodity Charge."

Amend paragraph 2.11.7. to read,

"2.11.7. System Entry Capacity Charges, NTS Entry Commodity Charges and Capacity Surrender Charges….. .."

Amend paragraph 3.5.1(ii) to read,

"3.5.1(ii) Commodity Charges ("NTS Exit Commodity Charges") ……."

Amend paragraph 3.5.3 to read,

"3.5.3 The NTS Exit Commodity Charge payable (for any Day) by a User will be determined (for each NTS Exit Point) as ….."

Amend paragraph 3.5.4 to read,

"3.5.4 NTS Exit Capacity Charges and NTS Exit Commodity Charges will be invoiced…"

Amend paragraph 3.5.5 to read,

"3.5.5 "…..the Applicable commodity rate of NTS Exit Commodity Charge in respect of a …"

"3.5.5(ii) "The NTS Exit Commodity Charge payable ..."

**SECTION S : INVOICING AND PAYMENT**

Amend Annex S-1, paragraph 4 to read:

"4. Commodity Invoice

A "Commodity Invoice" is an Invoice Document in respect of any or each of the following Invoice items:

(a) (i) NTS Entry Commodity Charges;
(ii) NTS Exit Commodity Charges; and
(iii) NTS Optional Commodity Charges;

(b) ..…."

Amend Annex S-1, paragraph 6(b) to read:

"6.

(b) Reconciliation Transportation Charge Adjustment in respect of the NTS Exit Commodity Charge …..."

Signed for and on behalf of Transco.

Signature:

**Nigel Sisman**
**Development Manager, Gas Balancing**
**NT & T**

Date: