

Workstream Report
Revision to the Notice Period regarding the implementation of changes to
Transportation Charges
Modification Reference Number 0073
Version 1.0

At the request of the Modification Panel, this Workstream Report was considered by the Distribution and Transmission Workstreams. Consensus was reached to recommend to the Modification Panel that the Proposal is sufficiently developed to proceed to consultation. The Workstream also recommended that the Panel should consider shortening the consultation period in order to ensure that, should the Authority so direct, the Proposal could be implemented in time for the Transporters to give four months notice of any changes to transportation charges to be effective from 1 October 2006.

1. The Modification Proposal

The Proposal, as discussed by the Workstreams, was as follows:

“The UNC TPD sets down a Notice Period for informing Users of changes to charges pursuant to Standard Special Condition A4(2) of the Transporter’s Licence. The Notice Periods contained within the Licence for informing the Authority and the Notice Periods contained within the UNC for informing Users are distinct, but not inconsistent;

- minimum one months notice to be provided to the Authority where the licensee has decided to implement any proposals to change the charges or reserve prices; and
- minimum two months to be provided to Users before the date on which its proposals...are to be implemented

Transportation prices contribute to the total supply costs incurred by suppliers in the business activity of providing gas to customers. These costs are defined by mechanisms outside of suppliers’ control, and suppliers seek the recovery of these costs through the charges applied to customers. The current notification methodology carries with it pricing disadvantages.

- i In the most competitive parts of the market the late notification of charges may result in unreasonable losses for suppliers as pass through contracts are both costly to enact and unpopular with customers. Such suppliers have to price keenly based on the information they have at the time and quotations may be necessary well in advance of the contract start date. With the increase in market volatility, customers are negotiating and tendering over a longer and more flexible period than the present two month notice period implies.
- ii Some suppliers may have customers who rarely change their supplier. In these cases the supplier can take a risk on raising prices to cover any possible increases in transportation charges. In such cases the customer ends up paying too much for the monopoly services the supplier is receiving and the supplier achieves extra margin via the recharging process.

In both scenarios transportation charges for monopoly services are adding a risk to the market that the customer will ultimately carry. In addition, there is the risk that the benefits of any charge decreases will not be passed on to those customers who have concluded negotiations well in advance of the contract start date.

Inaccurate transportation charges impact the structure of the competitive market and can distort the final prices paid by customers to the detriment of the market as a whole. An extension to the final notice period would ensure that suppliers have ample time to price contracts effectively, and therefore risk is diminished to the supplier community, and by extension to the customer.

The publication of indicative charges has historically aimed to help suppliers correctly price contracts. However, recently the indicative charges have been significantly different from the final charges and are therefore not proving helpful.

The accuracy of published transportation charges at the time of customer quotations will become increasingly important as DN prices become more disparate over time. Suppliers should be able to price contracts correctly by region, not simply smear the charges between all customers removing the element of cost reflectivity that Ofgem has been keen to maintain.

The proposal is that the current lead time for the notification of price changes should be extended from 2 months to 4 months.”

2. Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Competition may be frustrated in the supply market as the effect of transportation charge changes cannot be accurately calculated for all supply contracts. Under the terms of their Licences, Transporters are only entitled to change transportation charges once each year, effective from 1 October (NTS charges can also be changed with effect from 1 April each year). This is consistent with the start of the Gas Year, and many supply contracts run from 1 October. Increasing notice periods for transportation charge changes would facilitate suppliers being able to accurately factor into supply contracts the impact of transportation charge changes, especially in the case of contracts which are effective from 1 October in any year. Implementation would therefore facilitate the achievement of relevant objective A11.1 (d), the securing of effective competition between relevant Shippers and Suppliers.

Increasing notice periods for transportation charge changes would reduce the information available to Transporters at the time when changes to charges were determined. This would create uncertainty and be expected to lead to the setting of transportation charges which were less reflective of both costs and the maximum level of allowed revenue which Transporters are permitted to recover.

Reducing the cost reflectivity of transportation charges could lead to inappropriate cost targeting between market segments, and hence may be considered to be inconsistent with facilitating the securing of effective competition.

The increased probability of charges being set at a level which may not reflect the maximum allowed revenue might be expected to lead to increased levels of either under- or over-recovery in any given year. Increasing the probability of over-recovery would be inconsistent with facilitating compliance with Licence obligations since Transporters are obliged to endeavour not to over-recover. To the extent that over-or under-recovery was increased were this Proposal to be implemented, subsequent adjustments to charges would need to be larger - in order to offset the increased over- or under-recovery. This would be expected to increase price volatility from year to year, and hence potentially increase risk in the market, which would not be expected to facilitate the securing of effective competition.

To assess the potential impact on achievement of the relevant objectives were the Proposal to be implemented, Ofgem has indicated that specific information with respect to three areas would be useful:

- The actual timing of suppliers contract negotiations with consumers (when they start and how long they last); *Workstream attendees suggested that this is contract specific and varies according to the circumstances involved. Typically, a minimum of three months is involved for the negotiation process. The time involved is longest for public sector and the very largest customers. While contract start dates are varied, October remains the most common contract start month.*
- how long it takes for suppliers to reflect changes to charges in new bills; *Workstream attendees suggested that two months notice of changes to charges is sufficient time to facilitate accurate billing in the case of contracts with a pass-through arrangement for transportation charges. For other contracts, the change can only be reflected in bills following the renewal date, but can be reflected in offered prices almost immediately.*
- for DNs, the timing of information available on actual revenue and how long it takes to reflect this in final charges. *National Grid Distribution suggested that if transportation charges had to be finalised by 1 June, a key element of demand forecasts, NDM demand forecasts, would not be available. In addition, outturn revenue, and hence the level of carried forward over- or under-recovery from the previous financial year would not be confirmed by 1 June. Other DNs suggested that while they had no experience on which to draw, their processes had been built around the existing timetable and would need to be reconsidered if the Proposal were to be implemented. As an additional issue, National Grid NTS pointed out that using earlier information to set the SO Commodity Charge would be expected to lead to inaccuracy given the factors which influence allowed revenues, with gas prices being the biggest element.*

3. The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No significant impact on security of supply, operation of the Total System, nor industry fragmentation, would be anticipated were the Modification Proposal to be implemented.

4. The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

Implementation of the Modification Proposal would not be expected to significantly impact operation of the System.

b) development and capital cost and operating cost implications:

No such implications have been identified.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

No such cost recovery has been proposed.

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

While associated notice periods would be modified as a result of implementing the Modification Proposal, no consequences on price regulation would be anticipated unless Ofgem or the Transporters were to propose Licence changes which reflected the modified Network Code. However, National Grid has indicated that in order to comply with Licence obligations, implementation of the Modification Proposal could lead to them seeking to amend the level of transportation charges more frequently than otherwise. While the licence contains an obligation not to amend transportation charges other than with effect from 1 October (plus 1 April for NTS charges only), this is a reasonable endeavours obligation. By contrast, the Licence obligation to not recover more than the maximum allowed revenue is stronger and it could be argued that failure to reduce transportation charges if even a small over-recovery was projected could be regarded as a Licence breach.

5. The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

No such consequences have been identified.

6. The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

No such implications have been identified.

7. The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

An extension to the final notice period would ensure that suppliers have ample time to price contracts effectively. Therefore risk would be diminished for Shippers and, by extension, customers.

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

By increasing certainty regarding the level of transportation charges, the risk faced by Suppliers may be reduced. Consequently they may be able to offer lower prices to consumers than would otherwise be the case.

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

No such consequences have been identified.

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

Advantages

- Suppliers would be able to more accurately factor into supply contracts the impact of transportation charge changes.

Disadvantages

- The Transporters would need to reschedule the processes for determining price changes
- The information underpinning the setting of transportation charges would be more out of date, which increases the potential volatility of charge levels.
- The level of transportation charges may be adjusted more frequently than otherwise.

11. Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Workstream Report)

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

No such requirement has been identified.

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is not required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

14. Programme for works required as a consequence of implementing the Modification Proposal

No programme of works would be required as a consequence of implementing the Modification Proposal.

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

Following discussion at the Workstream meetings concerning the possible need for transitional arrangements should the Modification Proposal be implemented within four months of a potential change to the level of transportation charges, the Proposer amended the Proposal to include a view that, should implementation be delayed until after a price change was made, the Transporters should nonetheless provide as much notice as practical of any proposed change.

16. Implications of implementing this Modification Proposal upon existing Code Standards of Service

No such implications have been identified.

17. Workstream recommendation regarding progress of this Modification Proposal

The Workstreams believe that this Proposal is sufficiently developed to be issued for consultation and that a shortened consultation period would be justified.