



Frances Warburton  
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Ofgem  
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Dear Frances,

### **The Regulation of Independent Gas Transporter Charging**

Innogy, on behalf of all its gas supply businesses, welcomes the publication of the draft proposals on the above, and commends Ofgem on the analysis they have undertaken.

The benchmark analysis of IGT charges and costs seems to confirm that IGTs would appear in general to be able to sustain a viable business based on Transco equivalent charges, and provides no obvious explanation for why IGT charges are on average 36% higher than those of Transco.

Whilst analysis of IGT costs was limited to just six out of the ten IGTs currently operating in the market and was of a limited sample size, we do not believe that further analysis will serve any great purpose. The fact that IGTs were given the opportunity to validate the results of the analysis undertaken gives us a reasonable degree of assurance that the broad conclusions resulting from it are sound.

We agree with Ofgem's conclusions that the most appropriate way to tackle this monopoly price inefficiency is by developing a system of relative price regulation. Transco is the most appropriate comparator to use as it can legitimately be deemed to be a default service provider to the majority of IGT network extensions in the future.

In Chapters 6, 7 and 8 of the document you ask for comments on a number of issues relating to relative price regulation, and these are addressed below.

#### Proposed approach to IGT regulation

Whilst we recognise the practicality of applying relative price regulation at site level, this could still lead to customers on IGTs paying significantly higher transportation than Transco's, as site level relative regulation will still provide IGTs the flexibility to structure prices across properties on each site.

To this extent we would recommend Ofgem consider whether a combination of site and property level relative price regulation could be devised, which could be applied in tandem throughout the price control period.

Whilst we believe that IGTs should in most cases be able to make cost efficiencies compared to Transco, at this point in time and based on the evidence presented, we believe the level of relative price control should be set equivalent to Transco's. However, this should be kept under review, and in our opinion should be linked to progress being made by IGTs in standardising and automating their registration processes, as this is an area where shippers incur significant extra costs.

During the course of the price control period it is important that an IGT's charges do not deviate materially from Transco's on either a site or property level basis.

This could be achieved by setting IGT property level charges equivalent to Transco's at the start of the price control period, or of a project. These would then be allowed to vary annually within a fixed tolerance of the Transco equivalent charges (e.g. plus or minus 10%).

At site level, charges in aggregate could be capped at the Transco equivalent level at the start of the price control period, or of a project. These could then be adjusted annually by  $RPI - X$ , where X represents the efficiency factor included within Transco's price control formula at that time.

In the event it was not possible for IGTs to comply with both these obligations in any one year, the relative price control formula at site level should take precedence. However a mechanism should be created whereby IGTs can seek Ofgem's permission to exceed the property level tolerance in such circumstances.

Price control should be applied on the basis of set 5 year periods as this gives certainties to IGTs and shippers as to when the regulatory approach will be reviewed. It is also consistent with Transco's price control period. Whilst this might create uncertainty for IGTs developing sites near the end of a period, the alternative proposals of rolling reviews or phased reviews will do little to remove the uncertainty and inconsistency surrounding IGT transportation charging. They would also require regulatory action to be taken on an ongoing as opposed to a periodic basis.

Introducing performance measures for IGTs may be appropriate in due course. However, we do not believe it would currently be beneficial or practical to introduce such measures in a form equivalent to the IIP measures that prevail in electricity distribution. In our opinion the issue of IGT performance measures or service levels would benefit from a separate consultation, and it would be more appropriate initially to concentrate on establishing performance measures around key aspect of an IGT's connections and registration process than on their supply performance.

Transco's structure of distribution charges will always include an element of compromise as full cost reflective charging at LDZ level is neither practical or desirable. Nevertheless we would support a further review by Ofgem into the structure of Transco's LDZ charging based on the utilisation of the varying pressure tiers of their distribution system. Such a review should not delay the introduction of relative IGT price regulation, and so it would be sensible to provide for any adjustments in methodology and pricing resulting from such a review to be fed through into any new IGT price regulation that will be applied.

In our opinion relative price regulation is unlikely to present any extra barriers to non domestic consumers, or consumers in infill areas, obtaining a connection to gas networks. We therefore would not support any derogation being given to IGTs for this reason, or for IGTs to be allowed to annualise upfront connection charges and include these within their transportation charges to shippers. Any concerns in relation to such customers should be addressed through separate financial schemes being put in place between IGTs/UIPs and customers.

The lack of uniformity in the use or estimation of AQs by IGTs is an issue which concern us as it can lead to difficulties reconciling IGT transportation invoices and accurately billing customers. We sincerely hope that the forthcoming AQ review being carried out by all IGTs later this year will address these concerns and go a long way to ensuring the AQ recorded by the IGT accurately reflects the meter read data shippers have obtained. Until this review is concluded however, we shall reserve our judgement as to what is the most appropriate measure for AQs used in transportation charging and how this might be adopted by all IGTs for billing purposes.

As Transco have published separate metering and transportation charges for some time now, we believe it is appropriate for IGTs to show metering charges separately in order to provide transparency to shippers. It is not appropriate for IGT metering charges to be subject to



relative price regulation and so making comparisons based on bundled and unbundled services would be misleading. In our opinion therefore, it is essential metering charges are fully unbundled from transportation charges prior to relative price regulation taking effect.

We very much hope that all transporters will decide to enter in the supplier governance arrangements being established under the SPAA, and welcome the work IGTs are currently undertaking to assess the benefits that may arise from doing so. In the event transporters do not enter into SPAA, enforcing issues such as standardised invoicing arrangements (which we would very much support), can only be carried out by way of licence changes and individual network code modifications.

Finally we agree with Ofgem view that relative price regulation will create benefits to customers which will more than outweigh the incentive that might arise for IGTs to focus on development of low cost sites.

#### Treatment of legacy sites

We firmly believe that it would be to the benefit shippers, consumers and IGTs themselves to remove the disparity that exists between different sets of charging arrangements as soon as reasonably practical.

Whilst it may not be possible to achieve total harmonisation due to the fact that Ofgem's consent has already been given to a number of long term IGT charging arrangements, we believe arrangements should be put in place to avoid this issue re-occurring, and that IGTs should be encouraged to migrate legacy sites across to new arrangements within a set timeframe.

Adopting a phased approach would seem the most sensible option to develop. This could be done by introducing new charging arrangements from a pre defined date (for example April 2004) and maintaining the interim measures until such time as these take effect.

Charges conforming to the interim measures could be required to be migrated by no later than April 2007. This date corresponds with the end of the current Transco price control period and the start of what we would envisage being the first concurrent review of all Transco and IGT charges.

IGT charges based on SLC 4 alone, and on pre 7<sup>th</sup> December 2001 SLC 4C arrangements, could at the discretion of the IGT concerned be migrated no later than five years after the introduction of the new arrangements. In the event they were not migrated, they should be ring-fenced under the existing arrangements until their expiry.

#### Financial ring-fencing of IGTs

We agree that standard licence conditions 43 – 47 contained within Section C of the transporter licence provide a level of protection to licensees against financial pressures that might arise elsewhere within the group, and in doing so they protect the interests of consumers.

However, we remain to be convinced that these conditions, which are very much geared to the activity of the dominant transporter, should be applied uniformly to all IGTs and are concerned that doing so might create a barrier to the effective development of competition.

There are two standard licence conditions which we believe would be appropriate currently for all IGTs, namely SLC 44 and 45. We also believe that introducing a modified SLC 46 allowing Ofgem to give their consent to alternative financial arrangements other than investment grade credit ratings, would be a sensible compliance measure to apply.



However, further analysis into the potential consequences resulting from an IGT failure would be sensible before introducing other measures, and if uniform provisions are to be applied to all transporters, we would consider it appropriate for these to be adopted on the basis of a pre-defined threshold of transportation revenue.

I hope you find our response helpful, and please do not hesitate to contact me should you wish to discuss it further.

Yours sincerely,

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