TOTAL GAS & POWER LIMITED

Sonia Brown
Director, Transportation
Office of Gas and Electricity Markets
9 Millbank
London SW1P 3GE

27th July 2004

Dear Sonia

RE. INTERRUPTION ARRANGEMENTS – REGULATORY IMPACT ASSESSMENT

Total Gas & Power Limited (TG&P) welcome the opportunity to comment on this regulatory impact assessment. We have consistently advocated that if NGT are given formal consent to proceed with the sale of one or more of its DNs, that the minimum changes necessary are made to give meaningful effect to the sale.

The key issues put forward lead us to conclude that whilst incremental reform of the exit and interruptions arrangements may be necessary going forward, they certainly do not justify the need for wide-scale reform of the current regime. We also consider the concerns regarding the present arrangements are not sufficiently material as to warrant its reform being a necessary precursor to the potential sale of a DN or the cost and complexity of the 'market' based solutions proposed. Our specific comments in relation to the key issues are highlighted below.

NO UNDUE DISCRIMINATION & IMPACT ON CUSTOMERS

TG&P recognise the value of transportation interruption to a network operator reflects, inter alia, the value of avoided capacity investment to meet peak demand. We are not convinced by the arguments that suggest they should be viewed in the context of the costs to customers of providing different service levels and by extension a potential cross subsidy if a site is interrupted more than another. We note that little evidence has been put forward to demonstrate the extent of this supposed cross subsidy and further note that both shippers and customers have not communicated any particular grievance regarding this aspect of the arrangements. For the majority of interruptible volume transportation charges are a pass through element on their contract, hence the supposed cross subsidies referred to become even more elusive.

Our customers inform us that whilst they may prefer more flexibility in terms of the number of interruption days contracted they are reasonably comfortable with the system of discounts from regulated charges that underpins this regime. This in our view provides a relatively simple and non-discriminatory mechanism for those customers who elect to remain interruptible. We also note that very few customers have elected to convert from interruptible to firm.

FREEDOM TO CONTRACT ON MARKET BASED TERMS & EFFECT ON COMPETITION

Ofgem appear to have confused shippers with customers. We assume this is an oversight since interruptible services are provided by customers not shippers.

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TG&P agree in principle that the network operator should not be required to contract for more interruption than required, however, this must be carefully balanced against the need to provide customers with increased choice via a mechanism that does not lend itself to the problems of additional complexity and/or detract from the customers' primary revenue making activities. We consider the market based options proposed will unfortunately lead to these problems. Additionally, uncertainty in transportation charge exposure will probably lead to the introduction of risk premiums that we suspect will in themselves introduce cross-subsidies and ultimately be detrimental to supply competition.

Whilst contracting via market based terms is theoretically desirable we do not believe it to be viable in practice. The heterogeneous nature of the interruption products available, due to the localised nature of transportation interruption, coupled with the limited substitution available between these products simply do not lend themselves to the development of liquid markets, particularly when monopoly power is likely to be present either in the sale or purchase of the product. We note this was also the clear implication of Transco's presentation to the CIWG.

EFFICIENT INVESTMENT SIGNALS & SECURITY OF SUPPLY

TG&P consider the present locationally varying LRMC based methodology used to derive NTS exit capacity charges continues to serve the market well. It provides clear investment signals to those users with choice as to where to most efficiently locate their plant. This is also true to a large extent for customers on the distribution network who in addition to paying NTS exit capacity charges are also liable for distribution capacity charges that reflect the costs of the pressure tier to which they are connected.

We agree that network investment as a result of non-binding commitments from potential new connectees or those wishing to upgrade their capacity may lead to stranded assets. This does not, however, completely undermine the merits of the central network planning approach. A simple change to incorporate exit ARCAs, to make these commitments financially binding, would neatly address this concern. This approach does not require fundamental reform of the present arrangements and should promote stability in the charging framework for existing users.

Retention of the 1 in 20 planning obligations upon both the NTS and DNs is critical, we believe, to the delivery of efficient network investment and security of supply. This obligation facilitates a co-ordinated and planned investment approach between the NTS and DNs. One would reasonably expect the DNO to be in a better position to anticipate required investment than shippers, since it is more readily able to factor into its planning considerations issues such as; regional economic growth and demand for gas and the implications of planning applications/consents from/to developers of local amenities or infrastructure. In addition, this approach enables the network operator to take advantage of diversity affects and thereby facilitates efficient investment.

TG&P and many of its customers have serious reservations regarding the practicalities of the options where shippers indicate their capacity/interruption requirements three to five years in advance. Given the competitive nature of the gas

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market and the ability of customers to move relatively quickly between shipper portfolios we do not believe it is feasible for shippers to accurately notify the DNO of capacity/interruption requirements in the time frames proposed. Furthermore we do not believe it reasonable to expect Shippers to consider, or even be in a position to consider, some of the factors considered in the centrally planned approach or take advantage of diversity effects. The risk of over-investment or free-riding with insufficient capacity/interruption at peak is more likely under these proposals and hence we believe a real threat to efficient investment and/or security of supply.

EFFICIENT SYSTEM OPERATION DECISIONS

We remain deeply sceptical that the market based options proposed will facilitate the levels of efficiency indicated. Noting again Transco's concerns regarding the likely complexity and its limited ability to substitute for locational interruption, brings into doubt whether the SO would in practice be able to select the lowest price from a range of different priced offers. This leads us to conclude the proposed benefits in this area are significantly overstated.

LOW IMPLEMENTATION AND ADMINISTRATION COSTS

TG&P agree this is a key objective and recommend that all the options should be assessed using a risk assessment that quantifies the likelihood of the proposed costs and benefits being realised.

OPTIONS FOR RELEASE OF NETWORK CAPACITY

TG&P fully support the unconstrained capacity allocation option. This approach facilitates predictability and stability in the charging framework for shippers/customers and thereby facilitates supply competition. In this context the requirement on the network operator to contract for additional interruption when unable to respond to additional demand, by investing, in the short term is reasonable and cost-effective. Application of the exit ARCAs, referred to above, may also help to address the concerns regarding stranded assets.

PREFERRED OPTION

TG&P recognise that some elements of the interruption arrangements may be improved. We remain unconvinced of the need, however, to link these developments to the DN sale process or the need for wide scale reform. TG&P are particularly concerned that this linkage unnecessarily squeezes the development timeframe and jeopardises the implementation of robust interruption arrangements.

Of the options presented, clearly our initial preference remains for the status quo with interruption reform not being contingent on the DN sale process. We remain deeply sceptical of the market based options but do see merit in further developing Option 2a* in an unconstrained allocation environment. This would be consistent with the views of many of our customers who express support for retention of the system of pre-defined discounts against ex-ante published regulated charges for a pre-defined number of interruptible days.

Please contact the undersigned if you wish to discuss any issues raised in this

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representation.

Yours sincerely,

(This message is sent electronically and is therefore not signed.)

Sharif Islam
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