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Dear Samanta

Re: Structure of gas distribution charges; Initial proposals

Energywatch welcomes the opportunity to respond to the initial proposals document published by Ofgem.

As a general principle, energywatch believes that distribution charges should be cost-reflective, transparent, simple to administer and protect the interests of consumers. These objectives may not be complimentary in all instances, however, at all times it is important that Ofgem considers its primary role of protecting the interests of consumers. With this in mind, it is evident that pure cost reflectivity and economic theory must be weighed up against the overall costs of implementation to the various classes of consumers, not least vulnerable consumers.

Cost-reflectivity of use of system charges

energywatch believes that the current methodology based on average load size provides a simplistic and transparent basis for determining charges. Any move towards distance related charging would compromise this important attribute and add unwarranted complexity and costs to the charging mechanism. In addition, distance related charges are likely to introduce increased charges for rural and vulnerable consumers. For these reasons energywatch supports Ofgem's initial view that the current methodology should continue to be applied.

Capacity and commodity split

The current split may be arbitrary, but it should assist in encouraging consumers to reduce their consumption. This is due to the fact that a significant commodity element ensures that consumers can reduce bills by reducing consumption (this assumes that suppliers bill on a throughput basis). Moving towards a capacity bias methodology will, without question, drive suppliers towards standing charges which must conflict with environmental initiatives.

Ofgem makes it clear that due to the lifespan of pipes and the effect this has on marginal cost based recovery mechanisms that around 60% of allowed revenue is required to be smeared across all distribution charges. This significant "fudge factor" implies that the individual charge elements are

unlikely to be cost reflective and energywatch recommends that other principles must be considered. We see no reason to move from the current status quo, as this approach ensures; consumers are incentivised to minimise their consumptions; domestic and in particular vulnerable consumers are protected against price increases; and finally due to the significant smearing factor, it is no better, or worse, from a cost-reflective angle than the alternatives which propose an increase in the capacity element

CSEP charging function

energywatch believes that the gas connections market has proved to be a success. New entrants have established themselves and have made great inroads into Transco's previously monopoly business. It is important that distribution charges are fair and cost-reflective to ensure IGTs can continue to compete with the incumbent DNs. In an ideal world, the relevant charge for each connection would be individually determined ensuring that the transporters exactly recover the monies associated with the use of their assets. This approach would require differential treatment between connected systems and general transportation charges which immediately suggests a degree of discrimination between those consumers attached to a CSEP and those attached to the DN network. Secondly, connection specific charges would be complex to administer and unlikely to result in significant cost reductions for the CSEP customers, as it is assumed that IGTs will increase their charges under the RPC mechanism.

energywatch supports Ofgem's initial view that the current approach is appropriate and should be retained.

Economic Test

In light of our views expressed on cost-reflectivity, energywatch understands the need to retain the Economic Test. The Economic Test should reduce the risk of cross-subsidisation imposed by atypical load profiles and premature disconnections.

energywatch supports the proposal to vary the appraisal periods relating to the load types which should increase the likelihood of new load passing the Test.

Overall, energywatch believes the Economic Test should be designed in such a way as to promote new connections, particularly domestic related loads. This may require smaller contributions from new loads, but as the aggregate throughput increases this should lead to an overall reduction in average transportation costs.

Customer charge

In accordance with our views relating to capacity/commodity charging we are concerned with any proposal which moves away from commodity based charges. Again, this conflicts with energy efficiency aims and is likely to

impact vulnerable customers. energywatch is not convinced that a capacity based charge is more cost reflective as we suspect that there is a significant smearing factor applied to this function.

We do support a review of the customer charge to ensure that the 70:30 split between distribution charges and customer charges is reasonable.

Surveys and audits

energywatch fully supports a review and update of a number of data sources. In addition we support the adoption of alternatives to ABC analysis if the new DNs develop more robust models.

energywatch trusts that you find our comments useful and if you have any questions please do not hesitate to contact me.

Yours sincerely

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