STRUCTURE OF GAS DISTRIBUTION CHARGES
OFGEM INITIAL PROPOSALS CONSULTATION – JULY 2005

Response by Corus UK Ltd

Corus has the following comments :-

1. **Cost Reflectivity**
We agree that it would be inappropriate to introduce location or distance related charges

2. **Capacity and Commodity Split**
A move to a split that is reflective of costs is long overdue. In our view equi-proportional mark-ups are more appropriate, leading to a 99:1 split. We therefore favour Ofgem's option 3. This would eliminate economic inefficiencies in the present charging structure and is a valid way to proceed on a standalone basis without necessarily tying it to interruptions reform. As we have argued before (see our response to Ofgem's review in 2004, below), we do not accept that interruptibles are getting a favourable deal even on the existing 50:50 split. We are also not convinced by the counter-argument that suppliers may need to introduce standing charges to domestic customers. Some already do and others offer a two-tier approach, involving a higher priced initial tranche of gas, which is a surrogate for a standing charge.

   As to timing, we would support full implementation of a 99:1 split in 2007 with a partial change in 2006 to minimise price shocks for those adversely affected.

3. **Economic Test**
Ofgem's option 2 is preferable to the status quo although we think there may be difficulties in applying different appraisal periods for process and non-process loads. This would particularly be so for new industrial loads which cover both types, delivered through the same pipe and meter. Perhaps in case of mixed use some kind of mid-way appraisal period could be used eg 30-35 years

   We repeat our assertion that any interruptibles that are forced to become firm should not have to pay any reinforcement charges.

4. **Customer Charge**
Neither of the options under consideration address our concerns about this charge (see our previous response below). The customer charge covers service pipes, for which capacity may be a reasonable proxy, and provision of supply point emergency services, where a direct linkage to capacity is much more questionable. Costs incurred are more likely to be on a per customer/meter point basis. We therefore propose that the customer charge should be disaggregated into two elements, one which is correlated with capacity and the other charged on a customer/MPR basis.

5. **CSEP Administration Charge**
No comment.

6. **Survey and Audits**

Ofgem's proposals in this area seem sensible but waiting for the outcome of reviews/audits should not be a reason for further delaying change such as a move to a 99:1 capacity/commodity split.

SM
20.09.05

Corus Response to May 2004 Review of Transco's Distribution Charges 18.06.04

Dear Frances

Corus' comments on your review of Transco's distribution charges are as follows:-

1. **Cost Reflectivity**.

We support the principle of cost reflective charges, provided undue complexity and significant transaction costs are not created. For example, charging every individual consumer a site specific charge depending on location would not be sensible. The present postalised system is a reasonable compromise. There are, however, two areas where changes should be made to improve cost reflectivity - capacity/commodity split and customer charges.

2. **Capacity/Commodity Split**.

We have long argued that the present split of 50/50 is not cost reflective and therefore Transco is in continuing breach of its licence. Gas distribution is a high fixed cost operation and, unlike the NTS, has no compressors. The split should therefore have a higher capacity weighting than the NTS and we believe it should be 99/1. The current split is economically inefficient and results in cross subsidies in favour of low load factor users and of firm users at the expense of interruptible users. In this context we entirely reject Ofgem's long-held suspicion that firm users are subsidising interruptibles. No evidence or coherent argument has been advanced for this. On the contrary, interruptibles enable firm users to continue to receive supply during times of system stress. The discount for interruptible is effectively an insurance premium payable by Transco. Just because the extent of actual interruption may have been low in the past does not negate the benefit to Transco of having the option to interrupt.

If there are concerns about the impact on lower load factor users by moving to 99/1, such a move could be phased in over 2/3 years.

3. **Customer Charges**

It appears to us that this is another area where large users are subsidising smaller ones. It covers emergency work and service pipes - which will probably have been paid for anyway by premises connecting to the system. We have two large steelworks in S. Wales, which each currently pay a customer charge of £45,000 pa. This is hardly cost reflective and we believe that Ofgem should challenge Transco to demonstrate that its charging functions are cost reflective, particularly for larger sites. We note that a customer charge forms no part of the charging methodology for NTS connectees.

4. **Connection Charging Boundary**

On balance we believe the present "shallowish" policy is about right. However, given Ofgem’s stated intention of existing interruptible customers becoming firm at some future date, it would entirely unreasonable to ask those customers moving to a firm supply to pay for any reinforcement of the system.

5. **Economic Test**

Based on our past experience, Transco’s economic test is not transparent to the customer. We do not know if Transco now shares full details of its economic test with users requesting reinforcement. If not, this should be rectified.

The asymmetry highlighted in the consultation document certainly merits further consideration if the sums involved are material. If not, there many other areas - high wholesale gas prices for example - that Ofgem could focus resources on.

6. **CSEPS**

Any different charging for a CSEP should only reflect any differential costs imposed on Transco compared with a similar sized customer connected to Transco’s distribution system, otherwise another cross-subsidy would be created.

7. **Implications for Price Control/DN Sales**

The economically inefficient aspects of Transco's charging structure, notably the 50/50 capacity / commodity split, have persisted for too long and should have been corrected ages ago. As the main effect has been cross-subsidies between users, removing these should given priority. There should not be a material impact on Transco’s price control, although moving to a capacity based system would improve predictability of revenue.

As for DN sales, it would benefit users, suppliers and shippers to have consistent charging methodologies across Transco DNs and DNs under new ownership. Changes to Tranco's methodology should therefore be made forthwith or else Ofgem’s task may become more difficult with other DN owners to deal with in addition to Transco.

I hope you find our comments helpful and that you will be minded to act on our proposals for change, which is long overdue.

Please acknowledge receipt of this message.

Your sincerely, Stephen Macey.