



CHEMICAL INDUSTRIES ASSOCIATION

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Samanta Padalino
Head of Gas Distribution Policy
Ofgem
9 Millbank
London
SW1P 3GE

Kings Buildings
Smith Square
London SW1P 3JJ

Telephone: 020 7834 3399
Fax: 020 7834 4469

Direct phone: 020 79636718

Direct fax: 020 78348587

e-mail: brayh@cia.org.uk

www.cia.org.uk

Gas Distribution Charges: CIA Response

The CIA welcomes the publication of Ofgem's initial proposals on the structure of gas distribution charges. We look forward to working with Ofgem on this issue. Please find out comments to the general questions and more specific comments below.

General Questions

- *Whether Transco's estimate that marginal cost charging would allow DNs to recover only 40 per cent of their costs is robust?*

CIA believes that it is logical and robust that the approach taken by Transco would recover only 40 per cent of their allowed costs as there are large economies of scale associated with distribution networks.

- *which one of the proposed options would be more appropriate for the capacity/commodity split;*

The CIA welcomes a review of the current 50:50 split in capacity/commodity charges for gas distribution charges. We support the adoption of a much higher capacity weighting that better reflects the fact that the gas distribution business is dominated by fixed costs. At this moment, we would support the adoption of Option 3 but will have to see how this is progressed in line with the interruption reform. We would like to propose that a common split in capacity/commodity charges should continue to apply in all eight gas Distribution Networks.

- *what are the risks and consequences of all suppliers introducing a standing charge in the bills of final consumers under Ofgem's initial proposals for changing the capacity/commodity split;*

The CIA has no comment to make on this issue.

- *Whether and how it would be possible to make a robust distinction between process and non-process loads under the ET;*

CIA does not believe that there will be an issue between distinguishing between process loads such as chemical sites, and non-process load such as housing developments. However, if there is a mixture of sites connecting at one offtake point then this may need to be reviewed on a case-by-case basis.

- *whether the publication of additional information on the ET in the format outlined in appendix 2 would be helpful; and*

CIA supports the implementation of Option 2 to change the Economic Test to make it more transparent.



CIA members are committed to Responsible Care

- *whether such information on the ET would lead to gaming by potential new connectees.*

CIA does not agree that this would lead to gaming.

Capacity/Commodity Split

The CIA would welcome a review of the current 50:50 split in capacity/commodity charges for gas distribution charges. We support the adoption of a much higher capacity weighting that better reflects the fact that the gas distribution business is dominated by fixed costs. We would like to propose that a common split in capacity/commodity charges should continue to apply in all eight gas Distribution Networks.

Furthermore, the use of a function that is only capacity based could also improve the stability of DN revenues since capacity-based charges are fixed during the gas year and are revised only once a year for non-daily metered (NDM) customers, such as domestic users, to incorporate new meter read information. Therefore DNs may need to adjust their charges less frequently to ensure that they recover their allowed revenue.

We note that this work will need to be progressed in accordance with the proposed reform of the interruption arrangements for DN-connected customers. We would like to make the industry aware that it is very difficult for chemical sites to be able to predict their operations in advance and request that any proposal take our members' operational issues into consideration.

Economic Test (ET)

CIA supports the implementation of Ofgem's proposed changes to the Economic Test to make it more transparent and modify a number of parameters. The CIA agrees with Ofgem that the depreciation period used by the ET should be reduced to 45 years, and the discount rate should be set to 6.25% and revised at each new price control review. This will allow the depreciation period to reflect the most recent estimate of the average economic life of assets, and ensure that the depreciation rate is consistent with the prevailing allowed cost of capital.

We further support Ofgem's proposal to distinguish between process and non-process loads for which different appraisal periods would apply. The CIA does not believe that there will be an issue between distinguishing between process loads such as chemical sites and non-process load such as housing developments. Furthermore, we agree that process loads should be given an appraisal period of 20 years (at the moment it is 10 or 15 dependent on size), whereas non-process loads would be given a longer appraisal period.

The CIA agrees that this should prevent existing DN customers from subsidising the reinforcement costs of a new load, and that when compared to the existing ET, the overall effect of these changes would be to increase slightly the likelihood of a load passing the test and hence not having to pay for reinforcement costs.

The CIA supports Ofgem's actions to improve the transparency regarding the ET test calculation by requiring DNs to publish a full description of the ET. The proposed format and content of this requirement (as published in Appendix 2) is most useful in increasing transparency, and will help the investment decision process for new loads as they will be able to estimate their likely contribution (if required) from a very early stage. The CIA would however like to request that a fuller explanation be provided for the calculation of the capitalisation factor. Whilst a full and transparent explanation for the rest of this process has been provided we feel that the lack of a full explanation for the capitalisation factor detracts from this process. This could be easily overcome by providing an additional explanation and including the factors in the worked example to show how the capitalisation factor was derived.

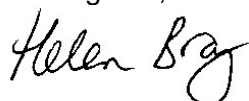
CSEP Administration Charges

CIA agrees with Ofgem that the, "existing charge is also transparent and simple". We believe that it may be appropriate to review the situation and assess whether it would become cost effective to move away from the current baseline.

At present, the overall costs associated with option 2, including both the costs of establishing automated process and the costs of accessing a network based information exchange, do not seem justified by the benefits, which are expected to be gained in moving away from the current data management system.

If you would like to discuss any of the above issue, please contact myself on 020 7963 6718.

Kind regards,

A handwritten signature in black ink, appearing to read 'Helen Bray', with a stylized, cursive script.

Helen Bray
Utilities Policy Manager
Chemical Industries Association
brayh@cia.org.uk