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20th September 2005

Structure of gas distribution charges – Initial proposals

Dear Samanta,

RWE npower welcomes the opportunity to comment on theses initial proposals.

Our comments below reflect the issues Ofgem have stated they would welcome views on along with other comments we believe Ofgem should consider when assessing gas distribution charges and in the forthcoming gas distribution price control.

Cost reflectivity of use of system charges

We support Ofgem's view that it is inappropriate at this stage to move away from the current postalised charging model to a distance or pressure tier charging model and fully expect this situation to persist throughout at least the next price control period.

As Ofgem recognise, any such move would require suppliers and transporters to make significant changes to their registration and billing systems. The costs that would result, along with the adverse impact on domestic consumers residing in rural areas, are unlikely to be readily offset by any cost reflectivity benefits, particularly bearing in mind the difficulties associated with quantifying such benefits.

Capacity and commodity split

Whilst it is apparent from Tranco's analysis that the present 50/50 capacity/commodity split is not cost reflective we believe Ofgem are right to consider how they should respond to this fact in a wider context.

If Transco's forecast of a 13% increase in DN peak day over the 10 years commencing 2003 proves to be correct then redressing this imbalance should in theory encourage more efficient use of DN assets and investment. Whilst there may well be a case for adopting a 99:1 or 70:30 split it should be noted that DN investment plans for the remainder of this price control have to a large extent already been set. Also, as pointed out in the consultation, Transco's modelling relies on certain inherent assumptions that may not be applicable to all customers in a sector group. It is difficult for us to assess the materiality of the current apparent inefficiency therefore.

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Increasing the capacity weighting of the split, and the distributional impact this will have on customer groups and competition in general, needs to be carefully considered. Ofgem's role of promoting supply competition is wider in scope than simply addressing one of what are a number apparent inefficiencies in transportation and metering cost reflectivity which may in theory discourage it.

Whilst we do not accept that the changes to the capacity/commodity split and reform of DN interruptions are intrinsically linked, we do believe that Ofgem are right to delay any changes until at least October 2007. This will allow Ofgem's decision on what is the most appropriate split to be factored in to their work on the new DN price controls.

Once a clear way forward on DN interruptions has been agreed and established Ofgem will need to undertake a fuller impact assessment on any proposal to change to the capacity/commodity split, as the distributional impacts shown in Appendix 1 are likely to be significantly different should Ofgem's preference for universal firm DN capacity prevail.

Economic test

We support the continued use of the economic test to avoid existing DN customers subsidising uneconomic new load. We also agree with Ofgem that this should be reviewed periodically and that different appraisal periods should be used for process and non-process loads.

Whilst we appreciate it may not always be possible to distinguish between such loads, a combination of load factor, standard industrial classification and AQ are likely to be sufficient to draw distinctions between them in the majority of cases.

Greater transparency of the economic test methodology will benefit shippers and consumers and should lead to a reduction in disputes, as will updating the discount rate used in the model. However, we do not share Transco's concerns that this will lead to gaming by new connectees.

CSEP administration charge

We welcome the reductions there have been in the CSEP administration charge over the years and are re-assured that Ofgem is of the opinion that this charge has reflected costs incurred by DNs in managing CSEP information under existing processes.

We agree with Ofgem that DNs should be obliged to review the charge on a regular basis, rather than as they see fit, and believe that a two-year timescale is appropriate.

As regards whether DNs should undertake a cost benefit assessment of switching to an automated process, we believe this issue should be considered as part of a wider debate about IGT registration services.

IGT registration relies heavily on the use of manual processes and non-standard file formats. As a result shippers/suppliers, and it would appear DNs, incur significant administrative costs when supplying customers on IGT networks in addition to those associated with energy and transportation.

It is possible that these administrative costs, of which the CSEP administration charge is but a small part, could be reduced and that the registration process could be made more efficient by rolling out the recently created Agency concept to IGT networks. We believe that Ofgem should give this serious consideration in its forthcoming deliberations on the next DN (and if appropriate NTS) price control.

Customer charge
We believe it is appropriate for DNs to undertake a review of the underlying costs that are recovered by way of the customer charge as the 30% of allowed distribution revenue this makes up seems intuitively high.

Charging the customer charge based on capacity only would seem appropriate bearing in mind that it relates principally to the cost providing service pipes and will increase the predictability of the charge and the scope for under/over recovery due to weather conditions.

As Ofgem intend to delay any change to the capacity/commodity split until October 2007 we question whether any move to change customer charges based on solely capacity should be introduced prior to this date, as the net effect of both these changes would be to increase the fixed cost element of gas transportation charges at the expense of the variable element.

Also whilst any move to a more fixed cost charging basis should introduce greater stability, any need to re-adjust the variable element due to under or over recovery could result in substantial percentage changes being applied to this charge.

Bearing in mind a number of gas suppliers (ourselves included) currently have domestic no standing charge tariff structures, changing the customer charge at the same time as the capacity/commodity split would avoid them having to consider the future relevance of such a tariff structure in a two staged manner, as the full impact of both changes (and any increased regional variance in charges) would occur at the same time.

Surveys and auditing

Following on from DN sales it would seem both timely and appropriate to introduce measures that will require DNs to review their cost of growth figures and connection by pressure tier surveys, and to audit their ABC analysis (or alternate cost apportionment models). As the assumptions therein and the accuracy of the data analysed are key drivers in determining use of system charges and how the economic test is applied, it is important that these remain fit for purpose both for the ongoing setting of distribution charges and the forthcoming price control review.

Other issues

RWE npower remains concerned that following DN sales the risk of fragmentation in DNs charging methodologies has increased, which could eventually require us to apply different charging principles to customers in different DNs.

In the event a DN were to propose changes to its charging methodology which were inconsistent with those of other DNs we would expect Ofgem to undertake a detailed and rigorous analysis of the impact this would have on industry participants and consumers before agreeing to any change. Sufficient time should also be given to allow for implementation of any resultant transporter and shipper system changes.

Also, whilst we recognise there have been steps taken to make information on the basic elements of NTS and DN price control more visible so as to allow suppliers to better predict the future direction of transportation charges, we believe there are still a number of key elements that are not readily available (e.g. the factors Z & F and the level of capex). In the forthcoming review of price control we believe Ofgem should give thought to what information can reasonably be made available to suppliers to assist them in anticipating changes to transportation charge, and how frequently such information is published.

In the event the capacity/commodity split is weighted more in favour of capacity a greater significance will be placed on the SOQ, which in the case of NDM loads is calculated using the EUC and AQ. To the extent a shippers NDM portfolio does not exhibit the typical offtake properties of the EUCs associated with it this will be reflected in RbD. However, whilst commodity charges and the commodity variable component of customer charges are reflected in reconciliation transportation charge adjustments capacity charges are not, and this may need to be re-considered to reflect the fact that a greater percentage of DN allowed revenue will be recovered through capacity charges.

Also as RbD adjustments can go back over a number of years, it will be necessary to further consider how adjustments that come to light after any change to the capacity/commodity but which cover a period pre-dating the change are managed, and the revenue implications arising. In the event this were to require shippers to support two different systems for reconciliation transportation charges calculated under the old and new charging methodology, this could be costly.

Finally, it may also be necessary to consider further whether the introduction of new weather correction variables from gas year 2005 will have any unforeseen impact on a change to the capacity/commodity weighting and the management of historic RbD adjustments claims.

Should you wish to discuss our response, or any of the above points in more detail, please do not hesitate to contact me.

Yours sincerely,

Steve Rose
Economic Regulation