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## Gas distribution price control review

Dear Joanna,

RWE npower welcomes the opportunity to comment on Ofgem's initial consultation on the proposed one year rollover and the main five year gas distribution price control review (GDPCR).

Our response incorporates our views on the issues for early decision, as laid out in Tables A2.2 of Appendix 2, and those issues for initial views in Table A2.3 where we have specific comments we feel are relevant.

### Issues for early decision

#### 1. *Related projects*

- 1.1. We agree that the list of projects shown in paragraph 2.24 are closely related to GDPCR and that issues arising from them and relating to them should be considered in tandem with GDPCR. This is particularly important in relation to offtake arrangements at the NTS with regard to the issues associated with universal firm capacity and whether flow flexibility is to be a separate or bundled product.
- 1.2. It is also possible that Smart metering could have a significant impact on the main price control in the event any policy decision to increase the pace of innovative gas metering technology were to be delivered through obligations on DNs.
- 1.3. Ofgem's forthcoming coming consultation on reconciliation by difference may also impact on the main price control in the event it was to conclude that a radical departure from current arrangements is necessary.
- 1.4. Finally whilst metering price control has been excluded from consideration, and may over time fall away, future developments in the structure of the metering market, Smart metering and the European Measuring Instruments Direct have potential to impact any extension to current metering price controls and possibly

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GDPCR itself.

## 2. Objectives and framework

- 2.1. This being the first GDPCR following National Grid's sale of 4 DN networks to new owners (DNOs) it is appropriate for Ofgem to put in place a regulatory framework to secure the benefits of comparative competition which were expected to arise from the sales. However, it is important to ensure that the principles underpinning the Authority's decision on DN sales are maintained. We would therefore expect Ofgem to reach their GDPCR conclusions having taken due account of the need to avoid fragmentation, maintain common charging principles, methodologies and charge codes and ensure that DN sales related costs are not passed through to customers.
- 2.2. Whilst it would appear sensible bringing forward work on the cost reporting framework so as to ensure that any changes will be in place in time for the main price control, the ability of DNOs to make meaningful projections of future spend will be equally dependant on conclusions having been reached on some of the related projects referred to earlier (e.g. NTS offtake capacity, xoserve). It would be disappointing if the benefits arising from Ofgem having earlier access to consistent and more accurate cost reporting are negated by uncertainties arising from a lack of clarity on core related issues, or for this to lead to compressed timescales for consultation towards the end of the GDPCR timetable.
- 2.3. Whilst it may be unrealistic to expect Ofgem to justify the 1.12% of efficiency benefit that was assumed in the Authority's DN sales decision to derive from comparative regulation within the next main price control, we would hope that Ofgem specifically reference and attempt to quantify benefits they believe have arisen as a result of DN sales in their final proposals consultation.
- 2.4. We believe that consumers on DN networks value reliability of service and minimum disruption, but that when disruption is unavoidable DNs manage this in a timely and efficient manner and keep them informed of events throughout the period in question. We also believe they value the provision of an efficient and co-ordinated connections service from DNOs, which sadly is something we believe they have been lacking over the last price control period. Finally, whilst customers rarely have cause to require the services of DNOs during instances of gas escapes and emergencies, we believe they welcome and broadly understand that there is an efficient system in place for responding to such circumstances.
- 2.5. As a gas shipper/supplier who is also customer of each of the DNOs we share these values, particularly in relation to connection services where we contract with DNOs to fulfil connector agreements we enter into directly with consumers. However, we also value greater transparency of core components of DN price control such that we can predict with a reasonable degree of accuracy the direction and magnitude of future changes to DN transportation charges.
- 2.6. As it currently stands we are not able to do this despite the welcome publication of information arising from implementation of network code modification proposal 698. We therefore welcome the fact that Ofgem intend to build on the work undertaken in this area for the current electricity distribution price control, and would strongly recommend that Ofgem engage shippers/suppliers when determining what information should be made available on an ongoing basis throughout the next main price control.
- 2.7. As well as predictability we also value stability in transportation charges, and the treatment of revenue under and over recoveries within price control has a strong impact on this. Whilst incentives currently exist to incentivise DNOs not to over recover, which we believe remain appropriate, we would like to see a capping mechanism introduced to limit the impact under recoveries can have on the variability of transportation charges. It may also be appropriate to look at enhancements to shrinkage procurement and incentive arrangements as part of GDPCR

as these are currently significant and unpredictable factors which influence this.

- 2.8. Due to the differences in the extent and duration of supply interruptions that historically has existed between electricity and gas distribution networks we agree that the appropriateness of the current gas distribution GS/OS arrangements should be considered as part of GDPCR. We also believe that the arrangements should reflect the fact that the impact of a loss of supply for an I&C customer will be more material than for a domestic customer where that loss of supply leads to loss of earnings rather than being an inconvenience. Compensation, we believe, should be set at more appropriate and variable levels reflective of the actual loss incurred.

### 3. *xoserve*

- 3.1. The creation of xoserve to act as a single interface between shippers and DNs was a vital step in avoiding fragmentation of core shipper/supplier registration and billing systems and we do not wish to see radical change in the operating or funding arrangements of xoserve during the term of the next main price control.
- 3.2. We do not believe it is appropriate for the Authority to define the agent role as a licensable activity and bearing in mind the high degree of linkage between those parts of the xoserve systems most relevant to shippers/suppliers and those parts most relevant to DNs, we do not consider it practicable for these systems to be unbundled during the period of the next main price control.
- 3.3. At this stage therefore we do not think the principle of user pays should be applied to all or part of xoserve funding, and we favour retaining the existing funding arrangements. However, we do believe there are improvements that could be made to the agency role and to UK Link governance arrangements, which would ensure shippers/suppliers have more direct input into the working undertaken by the agency and any system developments carried out on registration and billing systems.
- 3.4. For example, we believe it could be possible to assign a specific sum of money within xoserve's budget to use in relation to supplier driven initiatives or work requests. Alternatively xoserve members of staff could be principally assigned to work on behalf of shipper/suppliers, using their experience of xoserve's current systems and processes to analyse data and processes and work alongside shippers/suppliers to enhance and improve the efficiency with which they utilise these.
- 3.5. It may also be possible to introduce incentives into xoserve's funding arrangements whereby improved efficiency is rewarded subject to xoserve meeting an agreed set of steadily increasing shipper/supplier agreed key performance indicators.
- 3.6. Whilst we agree with Ofgem that it is important to ensure that price controlled revenue is not used to fund xoserve's commercial activities, and that xoserve should not be funded twice for its expenditure, we are anxious to see agency role extended to cover registration (and possibly billing) of IGT customers. If achieving this aim in a timely manner could be furthered by allowing for a proportion of any up-front development costs to be included within the one year or the early stages of the next main price control, we may be prepared to support this.

### 4. *Process*

- 4.1. We welcome the fact that Ofgem intends to establish an open and iterative dialogue with DNOs and other interested parties and believe this will be important in order to ensure that the benefits assumed at the time of DN sales are realised.

- 4.2. Whilst we do not believe it appropriate for the GDPCR working group to have shipper/supplier representation, we do believe that any issues arising from the work group which directly affect them should be brought to their notice, via the Gas Forum and SPAA for example.
- 4.3. We would also welcome formal inclusion of a post event review within the GDPCR process, as undertaken as part of the current electricity distribution, along with a seminar following publication of Ofgem's final conclusions.

## *5. Use of impact assessments*

- 5.1. We believe that separate impact assessments should be used to evaluate the costs and benefits of any materially significant changes to the existing regime or new initiative that are proposed during the GDPCR process, for example interruptions, LDZ offtake reform and the role and funding of xoserve.
- 5.2. We are not convinced there is a need to undertake a final impact assessment, and agree with Ofgem that this has the potential to increase workload for little meaningful benefit. Ofgem's suggestion that they could instead publish appendices setting out various policy options under consideration along with their respective costs and benefits should be sufficient to provide shippers/suppliers with the information they require. In the event this is not the case we would rely on Ofgem's commitment to open and iterative dialogue with interested parties to address such information deficiencies.
- 5.3. Finally, whilst we support Ofgem's use of impact assessments for materially significant initiatives and changes, we believe these should not be undertaken until details of these are well defined and understood. We are concerned that decisions to undertake impact assessments before options are fully understood (for example during DN sales) or as a pre-cursor to a further impact assessment later (as in the case of NTS offtake capacity) can lead to decisions being made which are felt not to be robust or credible.

## *6. Timetable*

- 6.1. Whilst the timetables for the one year and main price controls look achievable, past experience has shown that delays in making key GDPCR decisions and delays in related projects can snowball leading to significantly reduced timescales for consultation towards the latter stages the process.
- 6.2. The intention to start legal drafting early appears sensible therefore as this is invariably the most difficult thing to assess and comment on when faced with shortened timescales. As with impact assessments however, it can be counter productive doing this if the details surrounding GDPCR options and decisions are only defined at a high level.
- 6.3. In the event Ofgem find that as a result of responses to this consultation they are able to bring forward the date of publication of the second consultation (or for that matter the third and fourth) they should do so, as this may allow for more time to work and consult on the initial and final proposals.

## Issues for initial views

## *7. Principles for the conduct of the review*

- 7.1. We support Ofgem's proposals for rolling forward the RAVs in relation to the one and five year

price controls as this should facilitate more accurate projection of RAVs throughout the respective price controls periods.

- 7.2. We also agree that it is important for increases in capital and replacement expenditure, which arose from the loss of economies of scale due to DN sales, not to be included in allowed revenue and would like to better understand how Ofgem intend to achieve this.
- 7.3. DN sales transaction costs should also be excluded, and any future costs that DNs incur as a result of extending the SOMSA arrangements beyond their current terms should be scrutinised closely to ensure they represent a reasonable and efficient level of charging for provision of such services. This is particularly important bearing in mind the suggestion that major systems upgrades may be required to current DNCC systems within the next five years and that significant costs were incurred by National Grid in consolidating its area control centres both before and after they announced their intention to sell a number of DNs.

#### *8. Setting the one year control*

- 8.1. We previously supported Ofgem's decision to extend the current price control by one year and agree that the actions and work plan associated with this interim arrangement should be proportionate.
- 8.2. Ofgem's proposed treatment of capital and replacement expenditure for the one year extension appear reasonable and proportionate, and of the options proposed for treatment of operating expenditure we believe that carrying forward the existing opex assumptions to 2007-8 with a 2.5% reduction is most appropriate.
- 8.3. It may be appropriate to allow specific treatment for shrinkage by setting a one year ex ante allowance for gas costs prior to a wider review of shrinkage arrangements and incentives for the main price control. This may help to remove some of the unpredictability associated with shrinkage costs throughout the interim period.

#### *9. Structure of the price control*

- 9.1. We agree that the main price control period should be maintained at five years and that revenue drivers within the price control should be maintained to ensure that a DNO is neither penalised or over-rewarded for changes in the level of demand. We would however like to understand further the justification for the current 65%/35% split of fixed and demand dependant allowed revenue and of the composite user quantity calculation, in order to allow us to judge whether these remain appropriate.
- 9.2. We are not aware of any other items which the pass through mechanism should apply to. However, bearing in mind Ofgem's self imposed price control is now in operation it should now be possible to predict the extent of a DNs commitment to pay licence fees with a reasonable degree of accuracy, and so it may be appropriate to exclude these as pass through items.

Should you wish to discuss our response in more details please do not hesitate to contact me.

Yours sincerely,

Steve Rose  
Economic Regulation

Sent by e-mail so not signed