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Dear Joanna,

Initial Thoughts on the reform of interruption arrangements on gas distribution networks (85/06)

Thank you for the opportunity to comment on your consultation on the reform of transporters' interruption arrangements for customers connected to Gas Distribution Networks.

Overview

The issue of interruption arrangements has been under discussion within the industry over a number of years. The original concept of transporters' interruption was related to peak day capacity in that customers that did not require a gas supply on days of peak demand were not required to contribute to the provision of this peak day network capacity. Operationally, this was limited to customers of sufficient size where the gas flow could be monitored by daily metering.

Since that time, there has been recognition that there is a need for a more sophisticated product, which balanced the needs of the operators of the networks with those of consumers in the utilisation of this peak day capacity.

Within these discussions there have been assertions about inequity of arrangements, as some customers have undoubtedly not been interrupted as much as others. While we do not challenge this observation, we advise caution around the direct extrapolation of recent experience, since there has not been a period of sufficiently severe cold weather to approach a 1-in-20 peak day requiring the necessary level of interruption across large parts of the gas distribution network.

Naturally, it is for the Network Operators to identify the amount of transporters' interruption necessary and compare this against the need to invest to avoid constraints.

We believe that these initial proposals set the basis for these more sophisticated arrangements that will allow a balance between these requirements and the customers' willingness to offer the service to be achieved.

Specific Questions

Chapter 2 – Principles for Reform

Q1 Has Ofgem identified the key weaknesses of the current interruption arrangements for GDNs?

Ofgem identifies four key reasons why there is a need for reform:-

1. Lack of control over the amount and location of interruption – we concur that the current arrangements offer the operators of distribution networks little control over the quantity and location of interruption offered with the exception of Network Sensitive Loads.
2. Too much interruption – we believe that it is more difficult to assess whether there is too much interruption in absolute terms. The placement of transporters' interruption arrangements on the load duration curve is such that the absolute quantity required is related to peak demand on a 1:20 demand day. Until there is a reasonable amount of experience of these conditions it cannot be assumed that there is too much interruption. At industry meetings National Grid (previously as Transco) have often stated that if such conditions were experienced all interruptible sites would be interrupted.
3. Poor investment signals – although it is accepted that there may be no direct commercial driver of distribution network investment, it is not correct to assume that there is no investment signal at all. Even under the current arrangement, the Transporter will be aware of the extent of constraints on the system and the manner in which they could be alleviated.
4. Lack of flexibility – this point is closely correlated with the lack of control over location and amount and it is agreed that improved arrangements would be beneficial in achieving the balance of necessary levels of interruption.

Q2 To what extent do interested parties consider the current arrangements have sufficient strengths, and if so, what are these strengths?

The current arrangements are simple and well understood by the industry. The classification of a site as interruptible has the attraction of certainty and predictability for both Customers and their Supplier and Shipper. For the customer, in particular, this provides the knowledge that there is a continuing value in providing and maintaining alternatives to gas consumption. For many customers, we consider that "firm vs. interruptible" is likely to be a one-off investment decision, when energy-using equipment is replaced, rather than a decision that is revisited on an annual basis. We do have a serious concern that this decision may be marginal for a number of customers, particularly with the reduced differential between gas and oil prices, (cf. the long term trend for customers to "revert to firm"). The true effect of the influence of these factors upon the market will

generally work best under conditions of information certainty and transparency. If the proposed reform results in reduced transparency and predictability around the long term value of accepting DN interruption, then it could result in more customers opting for a completely Firm service than is strictly optimal, and hence an over specified network characterised by potentially inefficient investment.

Q3 Do you agree with Ofgem's key principles for reform?

Although we believe that there may be other means of achieving the objectives, we broadly agree that there is benefit in achieving this balance of correct quantity and location of interruption service between DN Operators and consumers with the involvement of their Suppliers and Shippers. Therefore, we agree that there should be scope for interruptible price incentives to vary by location and with the extent of interruptibility. However, as set out above, we do favour measures to ensure reasonable stability in the level of those incentives, over time.

Chapter 3 – Implementing reform

Q1 To what extent do respondents consider that the model so far developed by the GDNs meets Ofgem's principles for reform?

The mechanism proposed with a matrix comprising a number of days of interruption against a discount of transportation (capacity) charges is common to that which Exit Reform groups have developed in the past. In this respect we are supportive of the regime proposed. However, we have less confidence in the proposal for the manner in which the commitment is made to this range of products, as there is less certainty for the consumers in the longer term. We are of the opinion that the end consumer at a site able to offer an interruption service will need the certainty in the long term in order to commit to the installation, provision and/or maintenance of an alternative to gas consumption, plus the additional cost of stock and supply arrangements for an alternative fuel where applicable. Such costs are unlikely to be recovered over a timescale of three or five years. The operation of this annual tender will also give rise to additional costs over and above the current arrangement of prevailing rights of interruption.

We do agree that it would be necessary for the DNs to publish details about the nature and extent of interruption arrangements entered into following appropriate tenders. This aids the transparency of such arrangements and the DNs' performance against their incentives.

We believe that Failure to Interrupt arrangements should continue to be along the lines of the existing charges. These FTI charges place a very strong incentive upon Shippers, Suppliers and their customers to ensure that interruption is effected. The failure of a customer to interrupt places an untoward risk on the system as a whole and this must be appropriately incentivised. We are of the view that simply the loss of the exercise fee is unlikely to provide sufficient incentive.

Q2 Has Ofgem identified all the key interactions with the enduring Offtake reforms for the NTS?

We believe that there is a significant interaction between Interruption capacity and Diversification of Load on the network. The DN Operators have an opportunity to optimise the diversity of peak demand throughout their network and offset this with the requirement for Capacity and Flexibility products acquired from the National Transmission System (NTS). A critical factor in this equation will be the need for interruption on the distribution network. The manner in which these factors can be offset will need to be recognised within the incentive regime.

Chapter 4 – Incentives for the GDNs in the next Price Control

Q1 What is the appropriate form of an incentive on GDNs for the purchasing of Interruption?

This incentive must reflect the need for interruption in the circumstances of the expected level of demand. There should not be the opportunity for a “windfall” benefit where less interruption is expected due to warmer winters. The converse also applies, but we believe this is addressed by the ability of the DN Operators to enter into supplementary contracts for additional levels of interruption.

The incentive must also address the interaction of diversification of peak demand and use of the NTS (see above).

We are supportive of the concept of inclusion within the overall RPI-x control, as this would provide a strong incentive. Although we agree that the absence of caps and collars under such arrangements could lead to unlimited risk and the potential need for regulatory intervention, we believe that the likelihood of this risk materialising in practice is low.

We agree that there is a particular issue with respect to Network Sensitive Loads (NSLs). These customers are located at a specific point on the network where it is essential to be able to interrupt their load, in order to protect the continuity of supply to other customers. It is assumed that the cost of reinforcement necessary to alleviate this constraint is far greater than the loss of transportation revenue from the sites being classified as interruptible. Some customers with NSLs may prefer to have a firm supply and under these arrangements it could be discriminatory if this were not permitted within a reasonable period. We are concerned that the existence of these NSLs may be largely attributable to the lack of investment in the past and this must be considered as a factor in the determination of arrangements for the future if the current DN operators are required to invest to provide Firm service.

Q2 Do respondents support the continuation of a similar incentive to the transitional incentive for GDNs purchasing of NTS offtake capacity?

It would be consistent for incentive arrangements of similar structure to apply during the transitional period.

Summary

British Gas Trading are broadly supportive of the proposals to reform the arrangements for interruption of consumers connected to Distribution Networks. We believe that the publication of a matrix to identify amount and location of interruption necessary is a practical mechanism upon which to base these arrangements. However, we do have some concerns about method of sale and longer-term certainty for customers. There is a need to pay particular concern to the arrangement for NSLs with their specific role in the management of the network. We are also of the view that there is a need for appropriate incentives upon DNs to optimise their use of NTS service against diversified demand and interruption arrangements. We believe that a strong incentive upon contracting parties by means of FTI charges, or similar, should be maintained.

Please contact me if you require any further information.

Yours sincerely,

Mike Young

Commercial Manager