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28 June 2006

Your Ref: 85/06

Dear Lewis

Initial thoughts on the reform of interruption arrangements on gas distribution networks (DNs): consultation

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

General comments

We note that Ofgem has highlighted a number of concerns with the current interruption arrangements on gas DN's, the interface with offtake arrangements on National Grid Gas (NGG)'s National Transmission System (NTS), and whether this creates the best approach to efficient investment on gas DN's, the NTS, and allows those users willing and able to interrupt their gas supply to do so in the most effective way. We understand that interruptions ought only to affect very large users who may be in a position to interrupt without impacting security of supply generally.

Consumers expect that gas DNOs and NGG will deliver a secure, safe and reliable supply of gas at efficient and economic cost. From this perspective, interruption arrangements must incentivise users who are able to interrupt to do so to make optimal use of existing infrastructure, minimise the amount of new investment and potential for stranded assets, and help gas DNOs and NGG to invest efficiently when and where necessary. We would also expect consumers to be given clear sight of the benefits of the savings from efficient investment and the way in which those benefits will be shared with consumers.

Specific comments

We have the following specific comments on the proposed approach to interruption arrangements reform:

- The role of the regulatory impact assessment (RIA) is critical to the progress of reform, however, it will not be enough to provide a simplistic analysis of costs against benefits. Ofgem must then clarify how any identified benefits will actually, and not notionally, be shared with consumers directly. Shared savings have to

end up with consumers to soften the blows which they have suffered recently, particularly with rises in retail prices. If there are efficiency gains to be made, it is insufficient for gas DNOs and NGG to 'pocket' these or engineer the price control formulas in a way that allows savings to end up largely with shareholders. Gas DNOs and NGG, not consumers, are in the best position to invest in and operate their networks efficiently. They do so on behalf of all consumers and a direct route should therefore be established to allow resulting cost savings to pass to consumers.

- Linked to this issue is how distribution of potential benefits occurs. There may be a re-distribution of monies between groups of consumers (firm and non-firm users) if savings result but this will not allow monies to come directly to most consumers. That will only occur if overall transmission and distribution charges are reduced and given effect. We would ask Ofgem to state how it would approach this issue if appropriate savings are identified in the RIA.
- One of the benefits of a flexible and better incentivised interruption regime ought to be that there is more efficient spending on new infrastructure, better use is made of the existing infrastructure and stranded assets are minimised. If there are savings to be realised from this approach, the majority of consumers need to see the difference in terms of lower costs to them. The mechanism for setting any incentives on gas DNs should sit within their price controls to provide a degree of consistency between the overall approach to determining price control allowed revenue and the relatively small amount of incentive required in relation to interruptions. Ofgem notes the possible problems with setting incentives in terms of caps, collars and sharing factors but we believe that an appropriate formula could be developed rather than developing a mechanism outside of the price controls. We also believe that any incentive should be relatively simple to understand and not unduly complex so that appropriate savings accrue for consumers' benefit.
- We also consider that consistency of approach is necessary between the incentives under the price control relating to interruptions and those relating to purchases of off take from the NTS. The most efficient outcome requires gas DNs to purchase only off takes which are operationally efficient and meet demand which takes into account the ability to interrupt in a way that does not adversely impact security of supply. This will require appropriate long-term planning and effective interface between NGG and the gas DNOs. The separation of ownership of some gas DNs should not create discriminatory treatment in terms of information flows from NGG or hamper effective planning in this respect and we would ask Ofgem to keep this area under scrutiny.
- We have no particular views on dealing with locational issues of constraint and management of off take and interruption on this basis. Clearly, we recognise that locational constraints do occur, need to be relieved efficiently, and that consumers require assurances on security of supply resulting from management of constraints on individual gas DNs. We would ask Ofgem to ensure that there is a consistency of approach on application of the principles of constraint

management even if there are particular locational network issues to be resolved on specific gas DNs.

- We would consider one of the benefits for consumers of the gas DN sales to be the provision of comparative data from the non-NG gas DNOs to highlight whether, and how much, cost savings can be realised through different ownership. However, we are yet to see any definitive data of these cost savings. We would like to know from Ofgem, if those cost savings are realised, how it considers that they will be shared with consumers and whether this would impact on gas DNOs' actions on interruptions.
- We are concerned that only those users in a position to interrupt, knowing the effects of this action, should become involved in the arrangements with gas DNs which are incentivised. There is a live security of supply issue which needs to be considered. NHS Hospital Trusts, for instance, would probably not be best suited to interruptible contracts where there is a potential for load shedding to occur, particularly in circumstances (a 1 in 20 winter, say) where there would be acute risks relating to interruption and the ability to switch supplies back on. We also consider that there needs to be a consistent approach in the development of interruptions commercially agreed and paid for through contracts between shippers and large users and the incentives regime for interruption developed with gas DNs. A holistic approach should ensure that adequate and reliable interruptibility is possible at an economic price and there are no incentives on users to agree more interruption than necessary, creating increased risks to security of supply.
- We are not clear about Ofgem's information about the levels of actual capital expenditure which have been incurred compared to the allowed capital expenditure allowance provided in the five-year price control for gas DNOs outlined in paragraph 2.9 of the document. If capital expenditure has been significantly higher, then we would hope that the reasons behind the difference are brought out in the RIA.

Going forward, and particularly in relation to future price control consultations and proposals, we will keep these issues under review as and when they are raised, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs