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## Initial thoughts on the reform of interruption arrangements on gas distribution networks

Dear Lewis,

RWE npower welcomes the opportunity to comment on the above.

Reform of interruption arrangements on gas distribution networks is a subject that has exercised the industry for a considerable period and we have been an active follower and contributor to this debate.

We have consistently argued that reform needs to be pragmatic, proportionate, and co-ordinated with exit reform on the NTS and this remains our position.

Our non-confidential response to the questions raised in the consultation is included below. However, our response to the questions raised in the Impact Assessment is included in an Appendix which is confidential and should **not** be published on the Ofgem website.

### CHAPTER: Two

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

GDNs lack of control over the amount and location of interruption is in our view the key weakness of the interruption arrangements, although in the case of the most critical network sensitive loads GDNs do have a right to determine the amount of interruption they are required to provide.

Despite the fact that the number of sites choosing interruptible transportation arrangements has declined over the years GDNs are still likely to have more interruption available to them than they will need in the short/medium term. This is due to the fact that interruption contracts are of a standard 45 day duration and can now only used for transportation constraints purposes.

What has never been clear is the actual requirement for interruption and the distinction GDNs place on duration and deliverability, as with a single 45 day product there is no differentiation between these two aspects. This supports a matrix approach that allows the GDNs to sculpt their requirements.

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Network users have no idea of the GDNs actual requirements for interruption on their networks. This is mainly because there is little information on network capability published. In order for shippers and customers to make informed decisions about future GDN requirements and to assess these proposals, we believe that relevant data needs to be released.

There will undoubtedly be a distributional effect associated with these new arrangements which would increase in the event the current split between capacity and commodity used for determining transportation charges is weighted more towards capacity. However, the extent of any potential cross subsidy existing under the current arrangements has never been quantified, nor has it been established whether this constitutes undue discrimination.

We doubt whether reform to the current interruption arrangements will have any material effect on GDN investment signals as in order for this to happen customers are expected to have to offer to provide interruption at least three years in advance and potentially for more than one years duration, neither of which will be particularly palatable to them. The fact that GDNs are unlikely to need very much interruption in the medium term also makes it likely that the discounts they are prepared to offer customers will be less than (or certainly no greater than) current discounts, thereby effectively sending a signal to the market that very little investment to avoid interruption is required.

Nor is it clear how the GDNs will be expected to assess their requirements. Historically, they have been required to accommodate forecast load growth with reference to the 1:20 / 1:50 licence obligations and the short-term trade-off has been between interruption, reinforcement or LNG. However, it is not clear whether in future licence obligations will still be a part of the process and whether they will take precedence over other signals, always assuming such signals emerge.

Whilst customers may appreciate more choice over the extent to which they are prepared to offer interruption, particularly regarding the number of days and what proportion of any discount offered by GDNs they take in the form of an option or exercise fee, this choice is irrelevant if the reality is GDNs do not need what they have to offer.

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

The main strength of the current arrangements is their simplicity and the fact that they are widely understood by customers. Whilst not without their shortcomings, as the materiality and extent of any discrimination that may arise from them has never been quantified it is difficult to argue they should be completely replaced, hence we have always favoured an incremental approach.

As part of the GDN sales process Ofgem undertook a regulatory impact assessment on interruption arrangements<sup>1</sup>. Included in this was an option for incremental change to the current regime which was developed by a group of shippers (Option 2A\*) for consideration along with other options proposed by Ofgem and National Grid.

This incremental change proposal bears some similarity with the proposal currently being developed by GDNs, which is welcome, but does not require the three years advanced notice of commitment GDNs currently envisage or users specifying option and exercise parameters. We believe there is merit in reviewing this option once again and using it as a template for ongoing development of GDN proposals.

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<sup>1</sup> National Grid Transco – Potential sale of gas distribution network businesses. Interruptions arrangements Regulatory impact assessment - June 2004 (146/04)

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

As stated above we believe that GDNs lack of control over the amount and location of interruption is the key weakness of the current interruption arrangements and we therefore believe this should be the key principle for reform. If this key principle is followed GDNs might be able to make efficient trade offs between the cost of network reinforcement and the cost of purchasing interruption services, thus efficient investment signals may arise.

However, the timescale over which this trade-off can realistically be made given that long-term commitments may not be given by customers is a potential difficulty.

Now that interruption can only be called for capacity constraint reasons we see no benefit in creating a two-sided market where shippers offer interruption terms based on their alternative costs, as these costs are irrelevant to any GDN investment decision. The firm transportation price will be published and customers will need to compare this to the published interruptible discount and their costs of providing the interruption.

Reducing the scope for undue discrimination can be achieved by offering a standard matrix of terms based on GDN defined interruption requirements. However, in spite of this it is conceivable that the new arrangements could result in discounts being offered that vary significantly across Exit Zones, LDZs, networks or network owners, which would have a distributional effect.

Promoting competition between electricity generators is not a valid principle to judge new arrangements by as the majority of CCGTs are connected to the NTS, where different arrangements will apply. Instead a test of the new arrangements should be whether they result in any undue discrimination between CCGTs connected to the NTS and those connected to the GDN.

We strongly agree that the benefits of interruption should be balanced against the costs of implementing the changes and participating in the new arrangements, and that GDN interruption reforms should take account of the NTS enduring offtake reforms. Similarly NTS enduring offtake reforms should take account of issues arising from the reform of GDN interruption arrangements; for example customers reluctance to commit to interrupt for long periods and a number of years in advance should be taken account of when defining the parameters for NTS exit user commitment.

The current arrangements provide for interruptible customers being interrupted in advance of a gas supply emergency being declared (Stage 2). To the extent that the number of interruptible customers reduces as a consequence of these arrangements the NECs ability to prevent or delay an emergency being declared may be reduced. Whilst emergency interruption should not be considered as a key principle of GDN interruption, interruptible customers largely understand that they will be curtailed in advance of firm customers and can be expected to take this into account when choosing to be interruptible or firm.

### CHAPTER: Three

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

The model developed by GDNs, to the extent it is currently understood, fulfils the key principle of giving them control over the amount and location of interruption available to them.

However, we are concerned that the expectation that customers will have to give three years advance

notice that they wish to offer interruption during an annual window ,and that they might have to offer interruption for more than one year, does not fit well with the current practice adopted by gas suppliers of selling short term gas supply contracts during a number of annual sales rounds.

The transfer of contractual interruption obligations between shippers should be resolvable providing sufficient time is allowed for contractual, communication and process issues to be worked through before the first request for interruption services is issued. However we are concerned that the new arrangements could add extra complexity to billing and SPA arrangements, which will take longer and be more costly to resolve. It is also not clear how shippers will mitigate any exposure they face from interruptible customers going bankrupt prior to their contracted interruption period and whether this will require increased security to be put in place.

Some shippers with a small number of interruptible sites may decide not to take on interruptible sites if they are concerned about taking on a liability that they cannot manage or an increased operational burden. This may reduce competition between shippers.

The GDN model indicates that interruption requirements will be published on a locational/zonal basis. We would hope that these zones equate to existing LDZs or Exit Zones, as these are familiar to shippers/customers and included within current registration flows. In the event GDNs require more locational granularity than this shippers are likely to face increased costs as they will either have to accommodate changes to registration flows or put in place some other system of mapping their actual and potential customer base to these new zones.

*Has Ofgem identified all the key interactions with the enduring offtake reforms for the NTS?*

To the extent that interruption on a GDN is a trade off for investment in diurnal storage or acquiring NTS exit capacity, investment efficiency will be best served by timescales which are closely aligned. However, the danger is that in trying to achieve this aim you create barriers to customers offering interruption services they otherwise might have, which in turn will adversely impact investment efficiency.

Recognising the difficulties that will exist in customers having to make future interruption commitments during a single annual window, and as there is likely to be some flexibility in GDNs purchasing NTS exit capacity and diurnal investment timescales, we would encourage GDNs to look at developing more regular interruption windows with shorter lead times, so as to encourage greater participation in interruption tenders.

We are concerned that there will be insufficient time available to implement any new arrangements and communicate the impact of these to customers in time for an interruption tender in mid 2007 (for interruption effective in 2010). If implementation is rushed through the consequence will be an even lower level of customer participation than is currently feared, and what limited scope there is for interruption trade off will be completely foregone.

#### CHAPTER: Four

*What is the appropriate form of an incentive on GDNs for the purchasing of interruption?*

We are not convinced at this point that GDNs need an incentive for purchasing interruption as if there is a real trade off between interruption, investment in diurnal storage and acquiring NTS exit capacity GDNs will be naturally incentivised to choose the least cost option. The key problem with such an incentive is identifying an allowance that reflects an efficient level of interruption and therefore correctly incentivises GDNs to make efficient trade-offs, and information necessary to gauge this has never been

particularly transparent to shippers and customers.

Also as the levels of interruption GDNs will require are likely to be low, creating a separate incentive or building it into the main price control may not be justified on materiality grounds.

GDNs extensive knowledge of the flexibility they can call upon within their network and of the costs of diurnal investment is likely to put them in a strong position to negotiate favourable terms for any interruption incentive.

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

As stated above we are not convinced at this point that GDNs need an incentive for purchasing interruption after the transitional period.

In summary we welcome the fact that the proposals being developed by GDNs appear to be significantly less complex than some of the reform options Ofgem consulted upon two years ago as part of GDN sales. Nevertheless we are concerned that the proposals will still be unattractive or practically difficult for customers to take up, resulting in GDNs receiving limited investment signals from their interruption tenders. This will not necessarily be a problem for the market as a whole if GDNs are able to purchase NTS exit capacity as a trade off for investment in their network, but could disadvantage customers who are currently interruptible and who maintain expensive back up fuel capability to cover their likelihood of interruption.

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

Yours sincerely,

Steve Rose  
Economic Regulation

Sent by e-mail and therefore not signed