June 28, 2006

Ofgem consultation – Initial thoughts on the reform of interruption arrangements on gas distribution networks
Comments from the Association of Electricity Producers

The Association of Electricity Producers (AEP) is the UK trade association representing electricity generators. It has some 90 members ranging from small firms to large, well-known PLCs. Between them they represent at least 90 per cent of the transmission connected generating capacity and they embrace nearly every generating technology used in the UK. Many member companies have interests in the production and development of renewable energy where the government has set ambitious targets for development over the next decades

The Association welcomes the opportunity to provide comments on this initial thoughts consultation.

Chapter 2: Principles for reform
Qn 1 Has Ofgem identified the key weaknesses of the current interruption arrangements for GDNS?

The Association recognises that there might be some weaknesses with the current arrangements but considers these are a question of perspective and the timeframe under consideration. The issue of whether customers should have the choice to be firm or interruptible is relevant here. In the early days of interruption reform customer choice was considered a key objective this seems to have fallen in importance, yet this is often a key decision at the time the project is initiated or a new site built. As such it will influence whether back up fuel facilities are considered as part of the development. These new arrangements seem to prioritise the provision of investment signals to eliminate over-contracting and promote efficiency. Customer choice is secondary.

The timeframe is also relevant, there has been little interruption in the recent mild winters we have experienced, but that should not be surprising. It is also suggested that too much interruption is made available but no information is provided to substantiate this claim. How much of the current interruptible capacity would not be needed on a 1 in 20 peak day or 1 in 50 winter? –The longer term view would recognise the importance of these interruption volumes under more severe winter conditions. Similarly it could be argued that where sites opt for interruptible transportation when they have previously been firm that no investment will be required in that area to provide for firm load growth. Alternatively restrictions could be placed on such firm to interruptible switching. This seems to be the key issue that the proposals are trying to address, there may be simpler means to address this. Again there is no information provided to assess the magnitude of this problem. Although

the matrix of services approach will allow the DNs to profile their requirements for peak and duration rather than taking a 45 day flat slab of interruption.

The issue of lack of investment signals again seems to relate to the customers ability to switch from being firm to interruptible at short notice, which may be addressed in a different way. Also relevant here is the charging vs. investment cost issue. In theory the charges should reflect the cost of providing capacity at that point although as a result of averaging, cost variations within in the DN are not reflected in the capacity charges. Therefore the current 100% discount from firm charges is not considered appropriate. This could be considered an issue for pricing rather than the interruption regime….. It is this disconnect that makes it difficult for GDNs to make decisions regarding investment or interruption.

The document also comments on customer's costs on being interrupted. We accept that these feed into the price at which a customer might commit to offering interruption but we feel this is a commercial decision outside the scope of this document.

We agree that a limited range of interruptible products is an issue that might limit some customers offering interruptible services. The matrix approach appears to offer more choice but as the proposals seem to require the GDNs to define the services and prices it is not obvious that new parties will participate.

Qn 2 To what extent do interested parties consider the current arrangements have significant strengths, and if so, what are these strengths?
The Association broadly agrees with the commentary in section 2.13. We expect that when DN connected customers are required to focus on this issue they may well opt for firm transportation as the interruptible discount is almost insignificant in the context of current gas commodity prices. This may require significant investment in DN networks which may well not be necessary if the reforms are not progressed. In addition security of supply may not be enhanced as these volumes would no longer be available at stage 1 of a national gas deficit emergency and therefore potentially able to avoid declaration of stage 2. These volumes would only then be available at stage 3 via firm load shedding.

It is therefore essential that the impact assessment carefully considers these issues and risk of unintended consequences.

Qn 3 Do you agree with Ofgem's key principles for reform?
As we do not entirely agree with the weaknesses identified in the current regime it is difficult to fully support the principles of reform. However in isolation from the practical implementation the principles may be appropriate.

Clearly from a network perspective it is sensible that the network operator should not have to offer interruption services it does not need, whilst from a customer perspective this reduces choice and could lead to a fully firm network. Whether this is a desirable or indeed efficient outcome from reform will need further consideration.

Chapter 3: Implementing reform
Qn 1: To what extent do respondents consider that the model so far developed by the GDNs meets Ofgem's principles for reform?

The model would go someway to meeting the principles for reform and clearly gives the network operator a key role in determining the interruption it requires. As with many reforms the detail will determine whether the objectives are actually achieved. As identified in 3.3 and 3.4 much work is still to be done. In addition the charging methodology will need to be revised to establish cost reflective option and exercise fees for each product and duration.

Qn 2: Has Ofgem identified all the key interactions with the enduring offtake reforms for the NTS?
The document notes that the timing of purchasing decisions for DN interruption and NTS offtake capacity is a key issue. Also relevant is how NTS exit capacity charges will be recovered from DN connected customers once DNs book and pay for NTS exit capacity. As there may not be a simple one-to-one relationship between NTS offtake capacity and DN firm capacity we consider that this needs to be addressed prior to spring 2007 so that shippers and consumers are aware of the costs they may face.

In addition to make an efficient decision the GDN will need to know what the NTS exit charges are in order to compare them against its alternatives; reinforcement on its own network or offering interruption. Its not clear that the NTS and DN arrangements will be that closely aligned once the arrangements go live.

Chapter 4: Incentives for the GDNs in the next price control
Qn 1: What is the appropriate form of an incentive on GDNs for the purchasing of interruption?
Clearly it is reasonable that GDNs should be incentivised to efficiently purchase the interruption they require. However it should be recognised that any party operating under an incentive scheme will respond to that incentive, therefore the parameters are crucially important and will to some extent determine the outcome.

We do not have a clear understanding of how the arrangements will work and therefore are unclear about the points that discuss the uncertainty in the price level for interruption. It was our understanding following a presentation at EOWG on 17th May that the GDNs would set the discounts offered at certain locations based on its need for interruption at that location / cost of reinforcement, with the only option the consumer / shipper has to being the split of the discount between the option and exercise fee. Hence the cost of interruption may be more under the GDNs control than the document recognises. In this context if the customer / shipper does not want to accept the terms offered then they have to go firm.

We agree that issues arise from NSL sites potentially having market power, but consider that any incentive arrangements should include these. If as we understand the GDNs set the discounts for being interruptible then it would seem appropriate that these sites are offered a higher discount than other non-NSL sites, in so far as the

discount reflects the cost of that site going firm. However if the site does not accept this then it should be able to go firm just as any other site can. In this context it is appropriate to consider that NSL sites are sites where the cost of going firm exceeds the capacity charges that will accrue, whilst the converse of this is a site that can be made firm at no or low cost. In this model it would seem likely that such sites will not have the option to be interruptible or will be offered such a low discount that is not acceptable.

Qn2: Do respondents support the continuation of a similar incentive to the transitional incentive for GDNs purchasing of offtake capacity?
We agree that the inclusion of both short term and long term purchases of NTS offtake capacity in the incentive would seem to be appropriate. However we are unclear as to whether having separate incentives for offtake capacity and interruption is appropriate. The intention of the interruption reforms is to provide better signals as to the value of capacity so that the GDNs can make trade offs between investment, purchasing capacity and interruption. Therefore our initial view is that it would seem most appropriate for these to be covered by a single incentive to avoid any unintended interactions of having separate incentives.

Appendix 2 – Impact assessment information request
Below we provide some brief comments on this appendix.

Paragraph 1.3
We do not consider that any cost savings achieved by individual consumers on decommissioning back up fuel plant should be included as a benefit of reform. Any savings will accrue to individual consumers rather than the industry as a whole and will be likely to be offset by higher capacity charges.

Paragraph 1.4
Maintenance scheduling – we are not aware of proposals to change the existing rules by which maintenance is called on the DNs and make this a commercial issue.

Efficient decision making by embedded generators - we would welcome a more detailed explanation of this

Paragraph 1.7 Question 1 &2
We consider that answers to these questions could provide useful information to Ofgem in relation to demand side response, but are unclear as to the relevance of these when this document relates to transporter constraint interruption rather than commercial supply / demand interruption