



Joanna Whittington
Director, Gas Distribution
Ofgem
9 Millbank
London SW1P 3GE

28th June, 2006

Dear Joanna

Re: Initial thoughts on the reform of interruption arrangements on gas distribution networks

Introduction

Corona Energy ("Corona") wishes to submit the following in response to the above consultation document.

The response centres on the issues and questions raised in the main body of the document, however, it is our intention to consider completing the questionnaire provided in Appendix 2 at a later date.

At this stage, Corona understands the drivers behind the desire to reform interruptible arrangements, however, it is difficult to comment on the practicalities of reform until such point that the Distribution Networks ("DNs") have set out the implementation model(s). As a result, we look forward to commenting, in detail, on the UNC modification proposal expected to be submitted by the DNs in the near future.

Chapter 2 response

Question 1: Has Ofgem identified the key weaknesses of the current interruption arrangements for GDNs?

In general, Corona believes that Ofgem has identified the main weaknesses, however, it is important to rank, in some way, the impact each perceived weakness has on the market, and, most critically, on customers. We would argue that the primary weakness of the current arrangements is the customer's inability to more accurately signal to the DN the costs of interruption. The current discount to capacity charges does not allow for proactive pricing and results in inappropriate cross subsidies.

Corona does agree that the process for securing interruption is not sustainable and supports an approach which places the DN at the centre of the process i.e. identifying and contracting for a required volume of interruption.

We would argue that the remaining weaknesses are less convincing and are sceptical of the drive to improve investment signals. Transportation charges are not truly cost-reflective and transporter incentives are limited and fairly imprecise, meaning that it is unlikely that investment signals will be materially improved through reform in this area.

In summary, we believe that some level of reform can be justified by the need to better quantify and target interruption and to permit greater customer flexibility in the offering of turn-down services.

Question 2: To what extent do interested parties consider the current arrangements have significant strengths, and if so, what are these strengths?

Our response to question 1 above is consistent with the views expressed by other parties. Corona would support minor reform to the current arrangements which build upon the standard 45 day product. Customers should be afforded the ability to vary their terms of their contract to better reflect the needs of their businesses.

In addition, we believe that the DNs should have some flexibility in determining the volume of interruption they require to ensure they can operate their systems in the most efficient manner.

Question 3: Do you agree with Ofgem's key principles for reform?

Corona has identified those areas where it believes reforms are necessary. In particular we agree with the primary principle, that being to provide DNs with some degree of freedom to contract and product flexibility. As already stated we are not convinced that "efficient investment signals" are critical, or indeed achievable.

The final two principles are laudable and in our view, are by-products of the primary principle i.e. in the event that the DN is able to better determine interruptible needs and is able to contract for that volume in a more flexible manner, then competition will be enhanced and undue discrimination better controlled. It should be recognised, however, that while transportation charges continue to be non-cost reflective then some degree of discrimination and cross-subsidisation is inevitable.

Chapter 3 response

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

As stated above, the model explained in this document is at a very high level and, therefore, we are unable to comment on its merits in any detail. Corona wishes to make it clear that we reserve the right to comment on any future modification proposal submitted by the DNs and that any comments made here are not definitive and may vary in light of the final proposals.

In principle we support the fairly simplistic approach proposed by the DNs which provides for a matrix against which customers, through their shippers, can submit offers. We support a flexible approach which permits customers to offer a range of durations at varied prices. In principle, we support the facility to offer multi-year services, but have concerns that the administration of these contracts needs serious consideration i.e. the interruptible contract must move with the customer and central systems must recognise; changes of supplier/shipper; the status of the offer; and the level of interruption called prior to switching.

We have a number of concerns with the proposal as outlined and expect these to be addressed during the modification development process. Firstly, there needs to be recognition that in some cases the market is restricted and it is unlikely that suitable levels of competition will exist to ensure that either offers are forthcoming, or if they are, they are at a “reasonable” price. This applies particularly to NSL’s where there is a definite need for interruption. It is not clear how such sites would be treated and whether the matrix approach will be suitably flexible to accommodate them. There are two factors which need to be considered in relation to these sites; should the sites be provided with the full value of the investment substitution; and should the DN be required to invest in network reinforcement where the customer does not enter into an interruption arrangement with the relevant DN? Corona understands that the issue of market dominance needs to be addressed and we hope that the DNs develop the thoughts prior to releasing the modification proposal.

Secondly, we are concerned that due to the high level of gas wholesale prices, the proposed methodology for determining the value of interruption may not be appropriate. The proposal suggests that discounts on capacity charges will continue to be used in the future and it is not clear that the discounts will be sufficient to encourage offers to be submitted. Corona understands that this is a level of detail which will be focused on during the UNC process, but we believe it is critical to the success of the model and needs to be addressed at the earliest opportunity.

Thirdly, we are unclear how the transitional arrangements will work, this is particularly important for sites which are connected after 2007 and require firm capacity.

Finally, due to the fact that discounts to capacity charges are due to be adopted as a basis for valuing interruption, we are concerned by the potential impact brought about by changes to distribution charges. Clearly, any changes to the capacity /commodity split will have significant effects and we are not clear if the discount to charges will be amended in the light of such changes.

Question 2: Has Ofgem identified all the key interactions with the enduring offtake reforms for the NTS?

There is an assumption that there is a direct relationship between NTS offtake capacity and DN interruption. Corona believes that this relationship is not clear and should not be overplayed. Interruption on the DN is used for constraint management and in many cases the constraint will be due to the volume of pipeline capacity available within the DN and not the amount of flexibility provided by the NTS. This is particularly true at the extremities of the DN systems. On this basis we are not convinced that there needs to be a “purchasing order” and suggest that the DNs should not be unduly impacted if they were required to contract for interruption before purchasing offtake capacity.

Chapter 4 response

Question 1: What is the appropriate form of an incentive on GDNs for the purchasing of interruption?

Clearly there is a direct linkage between the costs of interruption and the costs of direct investments in the DN network. As described above, the linkage is not so strong when considering the relationship between NTS offtake capacity and interruption. Due to the clear substitutability between DN network investment and interruption, Corona believes that in a “perfect world” the incentive mechanism should be based on the minimum cost solution i.e. if the cost of obtaining interruptible capacity is more cost effective than reinforcing the network then the DN should be rewarded for attaining the most cost effective solution. This is difficult to achieve as it would require an assessment of each individual contract against the cost of network reinforcement. As a result, Corona supports a more general approach to incentives and would support a stand alone incentive which sits outside of the price control. This would ensure that performance is more easily examined and where appropriate, reset to reflect changing circumstances. The setting of caps and collars needs to be considered, but they should be wide enough to ensure that the mechanism is not undermined.

In the event that it is shown that, in fact, the linkage between NTS offtake capacity and interruption is stronger than we believe, then it would seem sensible to consider developing a single incentive which seeks to optimise the utilisation of the substitutable products.

Question 2: Do respondents support the continuation of a similar incentive to the transitional incentive for GDNs purchasing of NTS offtake capacity?

Corona believes that the points raised in our previous answer are relevant to this question, most notably the structure of the incentive mechanism if it can be shown that the two products are close substitutes.

As stated at the outset of this response, Corona will consider the IA questionnaire provided in Appendix 2 of the document and may provide Ofgem with the information requested at a later date.



We trust you find our comments useful and if you have any questions then do not hesitate to get in touch.

Yours sincerely

A handwritten signature in black ink, appearing to read "K Farry", followed by a large, sweeping flourish that loops back to the right.

Kieron Farry