



Lewis Hodgart  
Gas Distribution Policy  
Ofgem  
9 Millbank  
London  
SW1P 3GE

E.ON UK plc  
Westwood Way  
Westwood Business Park  
Coventry  
CV4 8LG  
eon-uk.com

Richard Fairholme  
Tel: 02476 181421  
richard.fairholme@eon-  
uk.com

December 12, 2006

Dear Lewis,

## **RE: Reform of Interruption Arrangements on Gas Distribution Networks**

E.ON UK welcomes the opportunity to respond to Ofgem's update consultation paper. In order to frame our response, we would like to clarify we do not support the reform of either interruption arrangements as set out in Modification Proposal 0090 or enduring offtake reforms as set out in Modification Proposal 0116V. Any comments we make in this consultation response should, therefore, not in any way be interpreted as signalling our support for either proposal.

### **Chapter 1 & 2**

No specific questions are posed to consultees.

### **Chapter 3 – GDN Incentives**

We do not feel we are able to fully respond to the specific questions posed by Ofgem in this section of the consultation paper, as we find it difficult to comment on these proposals in advance of any decision by Ofgem on Modification Proposals 0090 & 0116V. Any interaction between exit capacity and interruption arrangements

E.ON UK plc  
Registered in  
England and Wales  
No 2366970  
  
Registered Office:  
Westwood Way  
Westwood Business Park  
Coventry CV4 8LG

will depend on the outcome of a decision by Ofgem and until that point there is simply too much uncertainty. Our position is clear: The current arrangements for NTS exit and interruption should remain in place as the enduring arrangements and this has been clearly demonstrated to be a prevailing viewpoint demonstrated through representations to Mod 0090 & particularly 0116.

## **Chapter 4 - Draft Impact Assessment**

### ***Question 1: Do interested parties agree with the estimate of the costs of implementing GDN interruptions reform?***

We believe that it is impractical to expect shipper/suppliers to fully cost the impact of these radical reforms when a decision on the “preferred” charging methodology was only made by the DN’s on the 29<sup>th</sup> November 2006. This allowed only nine full working days before the close of this consultation on 12<sup>th</sup> December 2006, in order to provide cost estimations. We believe this is a very stretching timescale, particularly given that other critical and extensive proposals, such as Mod 0116V and alternatives, are being consulted on in near parallel timescales. Nonetheless, we recognise the importance of an accurate Impact Assessment and wish to contribute as fully as we are able to in the restricted timescale. Hence, we believe that Ofgem should have regard to the following factors in calculating the benefits and costs of Mod 0090:

#### *The Cost to Consumers*

From an economic viewpoint, the existing regime may possibly be providing a cross-subsidy, where customers with interruptible status enjoy the cost-saving benefits of paying no capacity charge, while firm customers pay extra to compensate for the reduced capacity charge income. This may be a particularly inefficient arrangement where the interruptible customer is infrequently interrupted. They are, however, still able to be interrupted and therefore rightly are compensated for the additional costs associated with being an interruptible, such as provision of standby by fuel and dual fuel capability. Notwithstanding, we estimate that under the current arrangements, the current “subsidy” per customer is small. For example, consumer groups have quoted average transportation discounts for being interruptible of less than one pence p/therm. If the UK interruptible market is estimated to be worth approximately 5,000 million therms/pa, then the cost per customer (based on 20 million end consumers) would be less than £2.50 per annum. A very small price to pay, we believe, for a substantial contribution to security of supply.

We consider that a minimum of three years is not an appropriate period of time to be bidding for interruptible rights. It is not realistic in the current climate to consider that a customer will remain with a shipper for three to five years. Furthermore, if the costs

of formulating a strategy and bidding for interruption are passed through to customers, some of the financial benefits for the customer of becoming interruptible will be diminished. We believe that an “open tender” approach, which is favoured by the DNs, would be the most expensive and time-consuming process for shippers and customers. As a result, in order to minimise the financial impact to customers, if these unwelcome Mod 0090 proposals were to be implemented, we would strongly favour an administered price format.

If an open-tender approach was, however, adopted, we believe that, contrary to the current proposals for Mod 0090, it would be extremely useful for transparency purposes if the DNs published the probability of interruption. This piece of information is likely to be pivotal in formulating an accurate and cost-reflective bid for interruption as it could dictate the price a customer is willing to pay for the right. Where there is a small chance of interruption very little immediate financial benefit is afforded to the customer who chooses to be interruptible and therefore, the bid is likely to be low in order to reflect this. We would urge the DNs to re-consider making this information readily available to users in order to help procure the kind of bids that they require and to minimise time spent by Shippers on inappropriate bids.

### *Stranded Assets*

Stranded assets are a genuine concern for some of our customers, who have invested heavily in alternative fuel supplies to allow them to respond more readily and continue their commercial operations, when interruption to their gas supply is required. Our main concern on this issue is that by publishing their interruption requirements, DNs may exclude some of our retail customers with existing back-up supplies from being eligible for interruption. This will then place some customers in a difficult position regarding their back-up assets which will effectively become stranded and of minimal use.

Even those consumers that have not been interrupted in recent years still have to keep stand-by fuel and have equipment, systems and processes in place to ensure that they can interrupt if called upon to do so. Consequently, we would encourage Ofgem in considering this proposal, to ensure that the *full* costs of stranding existing valuable assets are factored into the Impact Assessment, rather than possibly just focusing on forward-looking costs

### *CHP Impact*

The impact on CHP plant is also a relevant, but apparently ignored consideration for the proposed interruption arrangements. The direct impact on “merchant” CHP plant of going firm will be that BM prices will almost certainly increase. CHP is not plant that would normally operate at baseload so it is not beneficial to run it as firm. As a

result, it would usually be commercially disadvantageous not to have the site nominated as interruptible. The key problem here arises where CHP plant is not required to be interruptible according to the new, revised DN requirements under Mod 0090. There is a significant commercial risk that such generation assets could potentially become potentially less viable if forced to operate as firm. Moreover, the direct impact of forcing CHP to operate as firm would be an almost inevitable pass-through of higher operating costs, resulting in higher Power prices and ultimately, potentially higher customer charges – all of which are unwelcome.

By its very nature, CHP plant is also a very useful, flexible asset in respect of interruption and contributes a significant resource where rapid demand-side response is required. As a result, we consider that CHP plant and its role within interruption arrangements has not been sufficiently considered and would urge Ofgem to consider this issue further in formulating their Impact Assessment and in making their decision on Mod 0090.

***Question 2: Do interested parties agree that Ofgem has identified the appropriate benefits of reform of the GDN Interruption arrangements?***

***Question 3: Do interested parties agree with Ofgem's estimate of the range of potential qualitative benefits of GDN interruptions reform?***

The benefits identified by Ofgem:

*(i) Better investment signals for the GDNs to allow better trade-offs to be made between purchasing interruption, NTS offtake capacity and investing in its network;*

Although the proposed arrangements *may*, in theory, provide a more efficient allocation of interruption rights than the current regime, the allocation of interruption ultimately will be dependent on DNs undertaking their own analysis and identifying where there is a need for it. Once identified, it will depend upon the willingness of users to enter into the open-tender approach. A lack of interest from users in any particular location may not be indicative of actual requirement; moreover the complexity of the proposed arrangements and the open tender process may serve as a dissuading factor to entering into the process, which may give misleading signals about the actual need for reinforcement on the network.

*(ii) Improved security of supply through greater certainty about the availability of interruption;*

We completely disagree that DN Interruption reform will improve security of supply. The National Emergency Co-coordinator expressed his concern at the proposals and the implications on the Safety Case and we believe, like many other parties, that

Mod 0090 will, in fact, potentially endanger security of supply. Changes as envisaged under Mod 0090 will mean that the UK is likely to lose an important tool in managing gas emergencies. We consider that, in practice, the complexity of the bidding process and finding an appropriate price to tender will dissuade a large proportion of customers from wishing to remain with, or gain, interruptible status. The DNs could, as a result, be left with a shortage of interruptible capacity and since the proposal relies on the economic “will” of customers to participate in the bid process, it seems impossible for DNs to plan ahead to manage this potential locational shortage.

In any event, a lack of interruptible capacity would simply move everyone one stage closer to a firm load shedding scenario under a gas emergency. Moreover, the implications of this are not limited to just national emergencies or peak winter demand, but as was demonstrated during a capacity constraint in the summer of 2003, widespread interruption was necessary in the south of England to avert the need for firm load shedding. This was not due to a shortage of supply of gas, but other factors, including offshore plant maintenance. Occurrences such as these may continue to present problems irrespective of current and planned infrastructure developments and insufficient interruptible capacity will compromise the effective management of similar unexpected situations.

*(iii) A more flexible market for the offering and purchasing of interruption services;*

We consider that the only real “flexibility” is that afforded, in theory, to DNs in preparing their list of interruption requirements. We foresee no benefit in terms of flexibility for the vast majority of our customers or generation plant.

*(iv) More efficient operation of the wholesale electricity market;*

Considering the adverse impact on “merchant” CHP plant, highlighted above, we believe that the value of this benefit is highly questionable.

*(v) Wider economic benefits from GDNs selecting sites to interrupt based on the relative value they place on being interrupted; and control for the GDNs of the amount of interruption purchased will reveal which GDNs are the most efficient, allowing benefits to be passed back to customers in future price control incentives.*

We consider that this benefit is neither quantifiable nor proven. We do not believe that the proposed reforms would *necessarily* lead to lower prices for end consumers.

## **Chapter 5: Developments to the Structure of Gas Distribution Charges**

### ***Question 1: Do interested parties have any views about the timing of the introduction of the new arrangements***

We have voiced strong concerns regarding this proposal in our response to DNPC01 – “Customer Charge Structure for the 0-73MWh Load Band”.

We supported in principle the proposed change from commodity-based to capacity-based charging for the 0-73MWh Load Band. We agreed that it would help to add greater certainty to distribution charges and reduce some risk associated with the current commodity-based charging regime. Our support for this change proposal did not, however, extend to the recommended implementation date of 1<sup>st</sup> April 2007. We considered that this timescale was too short to implement such a fundamental change and could potentially undermine the significant work that has gone on in the industry to developing the AQ review process. There is no evidence that the impact on AQ Review has been considered at all in the development of this proposal.

This proposed change would place much greater significance on the accuracy of SOQs for the 0-73MWh Load Band than currently. For the 0-73MWh Load Band, SOQs are intrinsically linked to AQ level and cannot be nominated as a separate value, unlike the >73MWh Load Band. Inherently, this then places greater significance on the AQ level for each customer.

In recent years, a number of initiatives, such as Modification 0640, have aimed to drive shippers to improve accuracy of their AQs for their >73MWh Load Band sites and AQs around the 73MWh threshold. Rules exist, however, which prevent the alteration of an AQ level (and therefore the SOQ) where the change is less than 20 per cent or 15MWh. Under the current commodity-based charging methodology, an incorrect AQ/SOQ has less financial impact on a shipper/supplier than an incorrect AQ/SOQ, where the charge is capacity-based. Since capacity is not recoverable directly by a shipper where nominated incorrectly, we consider that the move to capacity based charging for the 0-73MWh Load Band adds greater financial risk to a shipper/supplier if implemented half-way through an AQ Review year (October to October). Any 0-73MWh AQ (and SOQ) nominated as a result of the 2006 AQ Review process may not necessarily reflect the increased accuracy required by this proposal.

The AQ Review for 2006 is now complete and shipper/suppliers have been put at a serious disadvantage by the notification of this change after 1<sup>st</sup> October 2006, because they have not been able to factor this into their plan of action for managing AQs across all Load Bands. In short, we feel that any change to capacity based charging requires either a review of existing AQ Review policy or at the very least, notification in-line with the AQ Review process timetable. Alternatively, it may be prudent to consider aligning the AQ Review process with the proposed April to March charging year, but again this would require separate development and

consultation.

As this proposed change impacts multiple areas of a shipper/supplier business and all in different ways, we consider that an implementation date of *at least* October 2007 (and more likely April 2008) would be more equitable and would better facilitate competition. This would provide shipper/suppliers with reasonable notice and therefore place all on a more even footing, regardless of existing system development plans and financial forecasts for the current gas year.

***Question 2: Do the benefits outweigh the costs associated with changing the timing of changes to gas distribution charges from October to April each year to align it with changes in allowed revenue?***

E.ON.UK strongly supports a move to an annual review of gas distribution charges. This was something we voiced our support for as part of the DN sales process, so we are supportive of Ofgem's interest in pursuing this issue further.

If DNs were to move to a yearly review of distribution charges, we would not expect to see any dilution of the amount and quality of information that DNs publish in regard of under- or over-recovery of allowed revenue. Indeed, it may be necessary for DNs to help offset the risk to users of future charge changes by publishing *more* detailed forward-looking information. Although a move to an annual process *could* lead to larger swings in charging levels, we believe this risk is sufficiently offset in practice if there is a good level of information made available to users, which would help them to predict and manage future changes to charge levels.

If you have any questions or queries regarding this response, please do not hesitate to contact me on 02476 181421.

Yours sincerely

**Richard Fairholme (by email)**  
Trading Arrangements  
E.ON UK