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**Reform of interruption arrangements on gas distribution networks - An update**

Dear Lewis,

RWE npower welcomes the opportunity to comment on the above consultation.

In response to the questions raised in the consultation we would make the following comments.

<u>Chapter 3</u>

*Question 1: Which of the options proposed by Ofgem for setting a one year incentive for the GDNs purchases of interruption and NTS offtake capacity do respondents support and why?*

Each of the three options under consideration will require Ofgem to estimate the cost to GDNs of procuring interruption. This will not be easy in the initial transition to new enduring arrangements. If, as we expect, few shippers participate in the long term interruption auctions the costs of interruption are likely to be driven by the GDNs cost of network investment to remove constraints.

GDNs procurement of flat NTS exit capacity (and flexibility capacity if relevant) should be more predictable however, based on assessments of GDNs historic UNC offtake bookings and their long term development plans.

Of the three options presented we favour Option 2, as we believe this will create the strongest incentive for GDNs to minimise the costs of procuring offtake capacity and interruption. Overbooking of capacity (particularly flexibility capacity) to mitigate against all potential offtake scenarios should be discouraged and this option creates the strongest incentive for GDNs to undertake efficient trade off between the system management tools available to them.

Whilst this option could result in GDNs making gains or losses compared with the allowance, dependent on the weather, it is questionable whether these should be regarded as "windfall" gains or losses. GDNs have licence obligations to meet a 1 in 20 peak day standard and this standard will only occur very rarely. However, this does not excuse GDNs from ensuring they have capacity and system management tools available to meet it, which increases the likelihood of gains arising.

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*Question 2: What are respondents views on the factors that should determine the level at which the interruptions and NTS exit capacity incentives are set?*

These incentives need to be informed by the estimated prevailing cost of capacity (flat and, if relevant, flexibility) and the GDNs alternative cost of network investment required to remove constraints. In the event National Grid Gas move towards using a public domain NTS transportation charging model this will increase the visibility of the capacity prices to be used in deriving any exit capacity incentive. GDNs alternative cost of investment should be used in deriving any interruption incentive as in reality we believe that most sites (including NSLs) will opt for firm transportation arrangements.

*Question 3: Do respondents agree with Ofgem's proposal to set a one year incentive for GDN's purchases of interruption and NTS offtake capacity from October 2010 and longer term incentives as part of the GDPCR?*

We recognise the need for incentives to be in place in ahead of the fist interruption auctions. To this extent a one year incentive applicable to gas year 2010 may be appropriate. However, consideration should also be given to pushing back the date of the first interruption auctions, as the default 3 year investment lead time may not be needed for any investment likely to be required.

Alternatively consideration should be given to delaying commencement of the enduring arrangements until 2011.

<u>Chapter 4</u>

*Question 1: Do interested parties agree with the estimate of the costs of implementing GDN interruptions reform? Interested parties are requested to provide information about any costs they expect to incur to implement interruptions reform.*

We believe it was premature of Ofgem to adjust the GDNs estimate of costs downward to take account of the relative scale of their operations without reviewing these in more detail, particularly when the effect of this is to reduce these costs by approximately 30%.

We also agree that consideration should be given to estimating the cost of investment required to remove all existing NSLs, as this is the most likely conclusion of these reforms. This should be taken into account in the overall final impact assessment.

With regard to the estimated shipper costs, we do not believe that two responses represent a sufficiently large sample on which to make any judgement of shipper costs at this stage. We also do not understand why, based on such an inadequate sample, Ofgem considers it reasonable to regard their estimates as being at the higher end of a likely range as the opposite could just as equally be the case.

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

Better investment signals for GDNs (to allow better trade off between interruption and investment) along with a more flexible market for offering and purchasing interruption services could both be legitimate benefits of reform. However, the extent to which they are will depend on the extent to which shippers and their end user customers participate in these auctions, and we have strong reservations about this.

We do not believe these arrangements will improve security of supply through greater certainty about the availability of interruption. Whilst the few interruptible customers that are left may reasonably expect to be interrupted more frequently and therefore prepare for it more thoroughly, those who move to firm arrangements are likely to become more complacent. As there will be less interruptible load to call off during a Stage 1 gas supply emergency there is a possibility that a Stage 2 or 3 emergency will be declared quicker, in which case the NEC is more reliant on these customers to come off.

Nor do we believe these reforms will lead to more efficient operation of the wholesale electricity market. Few CCGTS are LDZ connected or on interruptible transportation contracts and those that are have the option of bidding for energy interruption on the OCM like other firm sites. If the likelihood of interruption is as high for energy as for capacity reasons then they could self interrupt in advance of being called to do so by a GDN.

Also a CCGT is unlikely to be able to calculate the option value of providing interruption three to five years in advance, and therefore is likely either to offer a very high option price that reflects this uncertainty (in which case it unlikely to be selected). Alternatively it may not offer interruption at all.

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

We recognise the difficulty in estimating what efficiency savings might arise from these reforms particularly as the baseline capital expenditure that would have occurred but for these reforms also has to be assumed.

We believe that a baseline capital expenditure based on historical average of actual spend is most appropriate, particularly as this coincided with a period of capex overspend.

Calculating a percentage efficiency saving against this baseline can then only be a judgement call and we find it hard to see why Ofgem believe the potential efficiency savings should have increased since GDN sales. On this basis an efficiency saving of 3% would seem most appropriate for estimating the benefits of both interruption reform and NTS enduring offtake reform. To assume any potential efficiency could have more than doubled in the last 18 months seems implausible.

As previously stated Ofgem should consider the information provided to them by GDNs on the costs of investing to remove NSLs in their network as part of the overall impact assessment. We believe this could more than offset any benefit arising from a potential percentage efficiency saving and is an inevitable consequence of these reforms.

Recognising the difficulty Ofgem have in quantifying the perceived benefits, and their reliance on judgement calls, Ofgem should not be overly critical of GDNS and shippers when they adopt the same approach in estimating the perceived costs they may incur.

## Chapter 5

*Question 1: Do interested parties have any views about the timing of the introduction of the new arrangements for the customer charge?*

Distribution Network Pricing Consultation DNPC01 demonstrated that the current basis for calculating

LDZ customers charges was not cost reflective, and that a move towards recovering these cost based on capacity was more appropriate.

It also indicated that the DNs thought there was considerable merit in introducing the proposed change on 1 April 2007 as increasing the proportion of capacity charges in the middle of a formula year could result in very volatile prices.

With this in mind we support the move to charge LDZ customer charges on a capacity basis with effect from 1st April 2007.

*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?*

We strongly oppose changing the timing of changes to gas distribution charges from October to April.

Fundamental changes of this nature should be properly consulted upon as part of a gas distribution pricing methodology consultation or discussion paper. It is not appropriate to consult on such a material issue within the confines of a general update consultation, whose principal subject matter is of little direct relevance. Doing so could suggest that the issue is being deliberately concealed, and it would be no surprise if a number of interested parties fail to spot that bringing forward the timing of distribution price changes is an issue currently subject to consultation.

Bringing forward the gas charging year will also require a licence change and using this consultation as the basis for any forthcoming statutory notice of a licence change is unacceptable.

As with all changes to gas distribution charges we would expect to receive a minimum of 150 days notice of indicative proposals, and two months notice of any final changes to be applied. Whilst Ofgem have the right to waive the 150 day indicative notice, as this is only a reasonable endeavours obligation, we do not believe this is appropriate in this case.

The reason for considering bringing forward the timing of price changes to April 2007 appears to be because of concerns about the possibility of very high price increases that are likely to arise in October 2007, as a result of the implementation of Ofgem's final proposals for 1 Year price control. Whilst it is true that the 11.5% average increase in $P_0$ prices has only recently been finalised, Ofgem's initial proposals (published at the end of September) did indicate an average increase of 9.7%. Ofgem's second consultation published in July, whilst not indicating the scale of any increases, did also highlight that GDNs were forecasting significant overspends in capex, opex and repex, from which parties could make assumptions about the likely direction of future prices. We believe therefore that GDNs had sufficient time to consult on bringing forward the timing of price changes last summer had they felt it necessary to do so. They would also have had sufficient time to publish indicative prices 150 days in advance if, as a result of the consultation, they believed that changing the timing of price changes was justified.

Shippers and suppliers are required to make projections of future gas distribution charges when setting their budgets and tariffs. This is hard enough as it is bearing in mind the restricted nature of information made available to them, but fundamental changes such as this (particularly at short notice) makes the job harder and increases their exposure to risk.

Whilst in a perfect world price changes would be set to recover revenue over a full price control year, under or over recovery is inevitable whenever prices are changed and as a result established mechanisms exist to deal with this. Moving the timing of price changes to April will not necessarily lead to a reduction in variability, as claimed, because the extent of any over or under recovery in any one price control year will not be known at the point at which indicative and final prices need to be set. This is not the case when prices are set from October.

In conclusion we believe this issue should be subject to wider consultation and in the event it is deemed to be of benefit, sufficient notice should be given of its implementation to allow parties to plan how to manage its impact.

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

Yours sincerely,

Steve Rose
Economic Regulation

Sent by e-mail and therefore not signed