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the voice of utility users
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Lewis Hodgart
Gas Distribution Policy Team
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Dear Lewis

Reform of interruptible arrangements on gas distribution networks

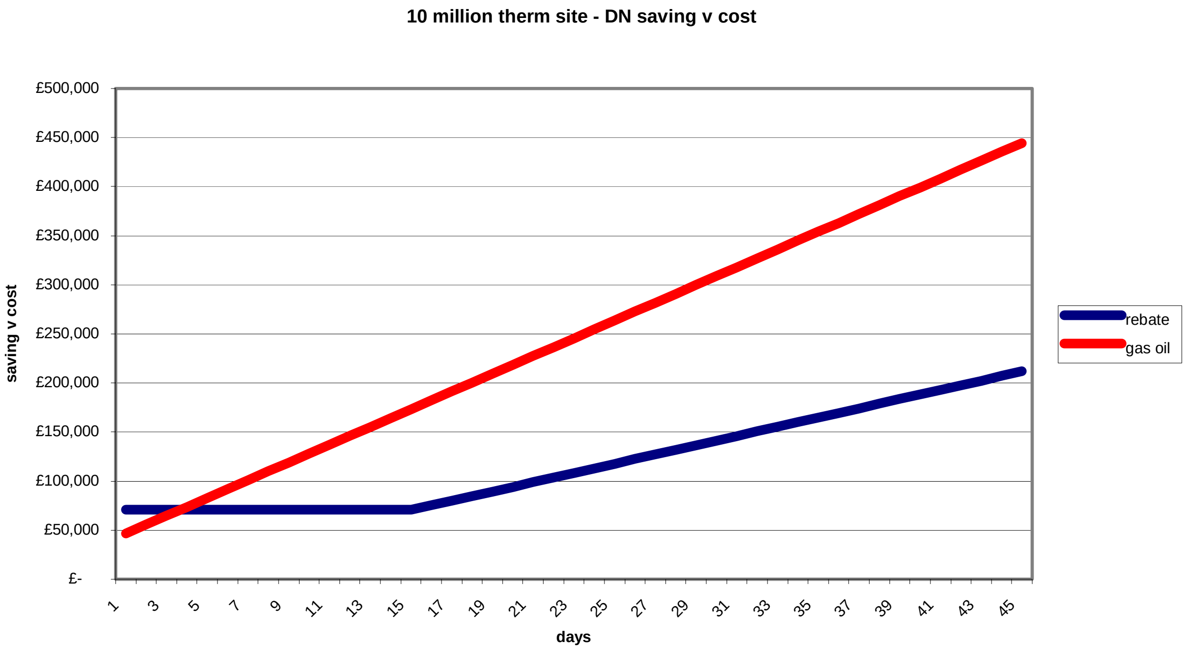
I am writing on behalf of the Major Energy Users' Council (MEUC), which is an independent body representing the interests of some 200 large industrial, commercial, retail and public sector organisations for which the cost of electricity and gas is a significant factor in its operations.

Our members' interests are split two to one in favour of firm gas supplies and therefore would support a proposal that was proved to be of benefit to consumers in general, however I feel that this has yet to be proved.

There are a number of concerns I have with regard to the consultation, the first being the approach used in the cost benefit analysis. It would appear that the cost of making a change, estimated at £15 million is to be recovered by an increase in efficiency of 2%. This I feel is back to front. If no change is made we do not incur this cost but could still look forward to efficiency gains. I believe that a definite befit should be the start point followed by the cost of implementation. The original Ofgem approach to this topic was that part of the £23 million rebate paid by DNs to interruptible sites was unnecessary and could therefore lead to lower charges to firm sites. However the DNs have failed to provide any information on what proportion of their existing interruptible capacity they require.

Moving on to the proposed auctions. I would support a change to a fixed fee for the right to interrupt followed by a per occasion fee when interrupted. I do however have concerns with the use of auctions. A consumers' ability to value his capacity in an auction I would suggest is limited. I believe that the consumer will have to rely heavily on the advice of their supplier. As the auction is for 3 years ahead, a period not normally covered by supply contracts, I question the advice/commitment of an existing supplier. I understand that the transporters have said that the rights and obligations will automatically transfer with the registration of the site, however I am not aware of any supplier actively supporting this view. If I was a supplier I would make one of two choices, either I would not bid for any interruptible sites coming up for tender or I would insist on a contract which covered the period I would be bidding for. Both of which I believe would further erode competition in the I&C market.

As for the auctions I believe that they will lead to higher costs for interruption on the DNs. I have produced the attached graph, which shows the cost for a 10 million-therm/annum site of maintaining and burning alternative fuel compared with the DN portion of the existing rebate.



Part of a consumers thinking with the existing interruptible regime is that as the site will seldom if ever be interrupted, except in a very sever winter, they are willing to accept the limited compensation provided. However if a site were to consider bidding in the auction they must assume that the frequency and extent of interruptions will increase dramatically. From the example above, at existing oil prices, the site would have to bid in £50,000 for the right to interrupt plus at least £9,000 per day when interrupted. The consumer bidding in such an auction faces the prospect that 3 years in advance they will have no idea what the cost of alternative fuel will be therefore the numbers I have just quoted could be far too low, for example we have seen energy prices treble within the last 3 years. As the cost of alternative fuel affects both the fixed cost of holding stock plus the cost per day of burning the fuel it will be extremely hard to decide what should be bid in an auction.

Bearing the above in mind I have discussed with a number of members whether they will bid in the proposed auction. The answer in virtually all cases was no. The general response has been that they will accept the transfer to firm status from 2010.

This then leads me to my next concern, which is, if there is little or no bidding in the auctions what will be the cost of reinforcing the system and subsequent increase in transportation charges? This again is an area where the DNs have failed to provide any data. I believe that this is a critical area, which must impact on any cost benefit analysis. I believe that the DNs should have provided an analysis based on various scenarios from zero to 100% bidding for the required volume.

Moving on to security of supply, I note that Ofgem believe that the proposals will improve security, this I would challenge. In your discussion I was concerned that you singled out one organisation for mention when suggesting that some organisations were not prepared to interrupt when called to do so. Particularly as the example quoted occurred during what was, and still remains a unique event, namely an interruption during the middle of summer caused by shippers choosing to send gas into storage and to the continent rather than ensuring their UK customers were supplied. If you truly believe that there are a significant number of sites that fall into this category I would suggest that the transporters are not meeting their licence obligation and therefore Ofgem are also failing by not bringing them to task. My reason for saying this is that the UNC provides for the DNs to interrupt for testing purposes on an annual basis if necessary.

Although this consultation is for distribution only we cannot ignore the potential impact of changes to the NTS exit regime. If the proposed changes are implemented National Grid have stated that it will eliminate stage 1 of the gas emergency procedure for NTS sites. This will remove 10% of the total annual load from stage 1. Depending on the amount of DN interruption required and the response to auctions, we will see a significant reduction or even a total elimination of stage 1 volume on DNs. As interruptible volume is currently 14% of total gas transported by the DNs such a change will bring on a stage 3 emergency and interruption of firm sites at a far earlier stage. I would argue that this is deterioration in security of supply and not an improvement.

My next concern is the treatment of existing interruptible sites that are no longer required. In order to be interruptible most sites have invested heavily in stand by equipment, the cost of which is recovered through their annual accounts over the life of the site. In a recent conversation with an electricity generator I was told that the cost of standby equipment installed on a 400MW gas fired station had been £4 million to be recovered over the 25-year life of the station. A station of this size operating at 75% load factor would use 200 million therms/annum. Applying these figures to the total interruptible capacity would give an investment of £150 million in standby equipment. Of course this ignores the economies of scale such a large site will enjoy, for example a 200,000-therm site could not obtain standby equipment for only £4,000! I believe it would be reasonable to double the calculated amount of investment to £300 million. If we then assume that on average equipment is halfway through its life, we still have £150 million to be recovered through companies' accounts, half of which is installed on DN connected sites. Therefore it is critical to know what percentage of the existing interruptible capacity is required in order that we can assess how much of the £75 million still to be recovered in DN connected sites will have to be written off.

Moving on to the treatment of new sites. Under the proposals if a new site approaches a transporter for a new connection and is told that there is insufficient capacity, the site will have two choices, either wait 3 years for reinforcement to take place or accept an interruptible supply and invest in standby equipment, but face the risk that the transporter could go ahead with the reinforcement making the standby equipment obsolete.

I also have concerns regard the term universal firm. Consumer have assumed that it means what it says i.e. from October 2010 all sites will be firm unless they bid into the auction for interruptible capacity. However transporters have implied that they will still carry out an economic test, which will give them the right to insist that sites failing the test will remain interruptible. In such a case the phrase "cake and eat it" comes to mind.

Moving on to the specific questions posed in the consultation,

Chapter 3 – rather than answer the questions I would question the need to provide an incentive. As the transporters have a guaranteed income I would have thought it was sufficient incentive for them to choose the lowest cost option for their operation.

Chapter 4 – I believe that I have answered these questions in my above response.

Chapter 5 – I would support the change in timing, as I believe it should lead to more stable and predictable charges from the transporters

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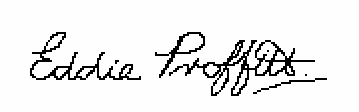
Yours truly,



Eddie Proffitt
Gas Group Chairman