

The Gas Forum



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Dear Joanna,

Re: Gas Distribution Price Control Review – Third Consultation Document

Thank you for the opportunity to comment on the above consultation. This response is provided on behalf of Gas Forum members. The Gas Forum is content that this response may be placed on the Ofgem website and in the Ofgem library.

In this response, the Gas Forum has chosen not to respond specifically to the questions listed in the document, believing these points are best addressed by members on an individual basis. However, there are a number of areas of policy in which we have common concerns, and which are listed and discussed below:

1) Information transparency & predictability of charges

A clear and consistent theme from Gas Forum members is the difficulty associated with predicting the future path of transportation charges. There are a number of elements, which make this extremely complex:

- a) Build up of over/under recovery throughout the year and between price control periods – i.e. the k factor

Whilst the Mod 698 reports are helpful, they are not all published to the same standard and do not give the full picture.

- b) Lack of visibility of the GDNs projected allowed revenues

Members would like to see all GDNs publish their projected allowed revenues through to the end of the formula year, highlighting if these figures change. It would also be helpful for indicative information to be provided for the succeeding year at least 6 months in advance.

- c) Lack of visibility of the GDN performance against Capex/Repex allowances

Members would prefer greater visibility during the next control period to avoid surprises such as the £840m overspend reported at the end of the last control.

The Gas Forum welcomes the type of reporting approach, which has been implemented in Electricity Distribution, and hopes that Ofgem will take full account of these concerns as part of the cost reporting consultation. Members would be happy to work with Ofgem to help define the requirements for the Gas Distribution equivalent.

2) Price variability

A second theme emerging from discussions within the Gas Forum is the approach to price variability.

There is some support for targeting reduced variability as an outcome of GDPCR, but equally, concerns that the ability to predict prices is more important.

It has been suggested that a move to more capacity based charging would be expected to reduce price variability. Whilst members recognise this potential, concerns are also noted about the way such an approach would reduce the linkage between customer consumption and transportation charges. This has implications for energy saving initiatives as well as cashflow implications for suppliers. There appears to be a clear preference to retain a proportion of commodity based charging.

In respect of the timing of price changes and the potential alignment with Formula as opposed to Gas years, there is a trade off to be recognised. Implementation of new charges from 1st April, would mean that such charges need to be calculated and notified before the winter months are completed. A second issue here is the fact that assumptions will also need to be made around the k factor, though clearer reporting may assist in this area. It may be that there is a case to be made for such alignment in future, but from April 2009. It has been suggested that this would allow a transitional 18 month recovery period for the very large changes expected in October 2007, with potentially a minor adjustment in October 2008. Such an approach, supported by clearer reporting, would allow proper planning by suppliers.

In the case of both the above issues, it is believed that the GDNs should fully analyse the different scenarios, and bring forward a Pricing Discussion Paper to facilitate informed industry debate.

3) Profiling

A number of Gas Forum members felt unclear about how profiling operates and what the real benefits are, finding the explanation contained in the consultation documents too limited.

In order for members to provide detailed responses, a more detailed explanation, perhaps with some worked examples would be welcomed.

4) Outcome of DN Sales

Having facilitated an industry discussion between Shippers and the NAO, the Gas Forum members welcomed the report from the Committee of Public Accounts, following the National Audit Office "value for money" audit of the DN Sales process, .

Particular points of note were considered to be the following recommendations:

- a) Establishment of comparator datasets for use in 2008

- b) A targeted approach to information gathering, focusing on cost and performance
- c) That efficiency savings of 3% per annum should be used as a starting position for the next price control process.

We hope that Ofgem will also support these recommendations as members believe that they will produce clear benefits to consumers within the next price control period.

5) Incentives

At an overall level, the Gas Forum welcomes the review of incentives. In particular we encourage Ofgem to consider the incentive regime as a whole, to ensure that incentive interactions do not create perversities. We have two more specific points we would wish to highlight:

a) Effect on charges

In addition to the points above, the Gas Forum believes it will be important to recognise the impact a number of incentive schemes, which cash out annually, may have on transportation charges. These impacts will be unpredictable for suppliers and will add additional uncertainty. It would be helpful if reporting of progress under the various schemes could be considered to assist suppliers in predicting the effect on charges.

b) Capacity Outputs and Exit Reform

There has been clear concern expressed by members in this area. Overall, the feeling is that a very simple, straightforward incentive is all that can be appropriately applied in the first instance, due to lack of certainty about the regime going forward.

A suggestion has also been made that it would be better to collect the data for an incentive scheme, but apply zero values in the first instance. Then, when 2-3 years of data are available, implement the enduring regime from the start of the next price control period.

6) xoserve & UK Link Replacement

The members of the Gas Forum have welcomed the more inclusive approach of the “Industry Dialogue” on xoserve and the UK Link replacement. Whilst a number of members do have concerns in some areas, overall we believe that the industry workgroup has been useful and we hope that Ofgem will find the report helpful.

We have grouped our comments below into three main areas:

a) User Pays and charging

Overall, we support the move towards more cost reflective charging for xoserve services in the form of a transactional “user pays” methodology where this is agreed to be appropriate. We have welcomed detailed engagement with xoserve and transporters to establish the correct framework arrangements for these charges. However, we believe it is important that the costs of reform in charging arrangements do not exceed the benefits derived, hence this should be subject to a cost benefit analysis.

Gas Forum members believe it is essential that all current core services must be maintained to current standards of service agreement. In addition, we support the introduction of a standard suite of service lines with a menu pricing approach. This support is based on the assumption that a “user pays” model is valid for the current situation, as well as a potential future model. It is also possible that as part of the process, members may be able to provide some information on projected future

transaction flows, which may help price stability across service lines. When considering the transactional services to be applied, it will also be appropriate to consider whether the charging year should be aligned with the Gas year or the Formula year.

Finally, in this area, Gas Forum members would support a direct contract between users and xoserve in order to encourage efficiency and contractual leverage, but note that all existing Transporter obligations in this area should remain in place.

b) Governance

In respect of governance, we believe that the minimum standard should be referencing of an ancillary document referenced in UNC. It will be important that Users have the ability to propose changes to the document, if this can be successfully achieved by way of referencing an ancillary document, then this would be an acceptable approach. In addition, as an absolute minimum, consultation with Users must take place before any changes are made.

It will also be necessary to establish a governance mechanism to support the charging methodology. In members' view, the charging methodology should be produced in consultation with Users and should not be changed in the absence of further consultation with them. In view of the fact that this is a monopoly service, we also believe that the methodology should be required to be cost reflective, and allow for no more than the rate of return which the DNs are allowed, or a rate negotiated with Users. Finally, we are of the view that Users should be able to appeal charges, either via a self-governed committee or to Ofgem. If an appeal is raised, then part of the appeal process should be publication of all relevant cost information.

It will, from time to time, be necessary to amend the charging statements which are produced as a result of the agreed methodology. Such changes should be notified by xoserve (after full consultation) with similar lead-times to those in effect for transportation charges.

c) UK Link Replacement

The Gas Forum is concerned in respect of the proposals to fund only a baseline of a "like for like" replacement of UK Link. We believe that there is a risk that such an approach may act to prohibit beneficial market developments within the lifetime of the new system, such as AMR. This concern is also relevant in the case of mandatory change as a result of changes to the Licences or regulatory framework.

For the UK Link replacement, we believe that there is a need for a formal obligation to be placed on the Transporters to provide, on request and in a timely manner, reasonable and detailed cost estimates for proposed new, major market developments, which are not part of "business as usual" or baseline activities.

We believe that in addition to the above, it will be necessary to develop, in conjunction with Users, a robust methodology for apportioning development costs. This should be completed in advance of implementation so as not to unduly delay change. We would also recommend that this methodology should also take account of Users who may, at a later date, wish to participate in changes previously developed at the request of a group of Users.

We suggest that a user-group should be set up to co-ordinate the development of such methodologies and the multi-lateral contracts, which would be needed to develop new service lines for relevant parties. It may be that the Gas Forum could assist in this area.

I hope that you find these comments from the Gas Forum helpful. Should you wish to discuss any of the points raised in more detail, Alison Russell, who chairs the Gas Forum subgroup on GDPCR would be pleased to co-ordinate queries. Alison can be contacted via e-mail at Alison.russell@centrica.com or on 07789 570046.

Yours sincerely

Steve Briggs
Chairman