John McNamara
Gas Distribution Policy Team
9 Millbank
London
SW1P 3GE

25th November 2007

Dear John

Re: LDZ System Charges Capacity Commodity Split and Interruptible Discounts

Further to your recent consultation, please find the comments of Total Gas and Power (TGP) below:

C2, Q1: What are the respondent's views on our assessment of the proposal against the objectives of the distribution charging methodology?

TGP concur with Ofgem that whilst 95% of costs are in effect fixed costs, this does not mean that they are related to system capacity, and therefore would question whether all of these costs should be recovered through this proposed new 95:5 split or whether this should fall somewhere between 95:5 and 50:50.

Stability in the Distribution Charges was helped by the removal of the volume driver in the 2007/08 price control and TGP believes that this should continue in the 2008/13 price control. The introduction of 95:5 will further increase this stability as it will bring collected revenue in line with allowed revenue. However if price stability is ultimately the desired outcome then TGP believes that there are better ways of delivering this. We would argue that, for example, GDNs should be allowed to recover their any un-recovered amount over a greater period of time. We suggest 2/3 years rather than the 6 months that they currently have which requires the GDNs to put an uplift factor of 1.75 on any increase or decrease in charges. TGP are not supportive of allowing the GDNs to change their prices twice a year, particularly if this modification is approved, as this would prove to be an additional administrative burden on the supplier and end user communities and would lead to further unnecessary uncertainty with respect to forward transportation rates.

C3, Q1: What are the respondents views on the methodology used to determine the distributional impacts of these proposals?

TGP does not object to the methodology used, however we would like to make the observation that the table showing the distributional effects only show the decreases for larger I&C supply points. There are also increases and these should also have been highlighted. Our analysis of the changes suggests that the increases can be bigger than the decreases highlighted, particularly on some of the interruptible sites where, as you have pointed out, the SOQs have diverged from reality. Whilst in percentage terms, the increases or decreases may appear to be insignificant, in absolute terms, they can represent material amounts for larger consumers.

In addition to this TGP would like to make the following point. Currently under the 50:50 regime, the GDNs recover approximately 43% of their revenues in the period April to September and 57% of their revenues in the period October to March. This will change under the 95:5 regime to approximately 50% in each period.

If the change were to be implemented in October 2008, assuming all things are equal, 43% would be recovered under the old regime for the period April to September 2008, but only 50% would be recovered for the period October to March 2009 under the new regime. This would leave a shortfall of 7%. Because the mechanism would require any under recovery to be recovered in the financial year April to March 2009, and because any uplift would only be applicable from October 08 onwards, this would require a price rise of 7/50 or 14%. Whilst we appreciate that for some of the GDNs prices are predicted to fall, this is not the case for all GDNs.

Given the problems caused to the supplier and end communities of last years price hikes this is not an issue that can be ignored. If this proposal is to be implemented and given that contracts tend to be for periods of 12 months or more, then consideration must be given to the implementation timetable. This is further exacerbated by the fact that we are already at the end of November. Our view on implementation is provided later in this response.

Looking at the following Formula Year, 2009/10, if all things are equal, in order for the GDNs to recover the correct amount of collected revenue, a price decrease of around 24% might be required from October 09. Thus, it seems to us that the outlook for transportation charges is far from stable under the proposed implementation.

C3, Q2: How do respondents view the proposal as it relates to interruptible supply points?

TGP have already noted the issue of SOQs diverging from reality, often over stating the position of their required capacity. This is an issue and we recognise that this has to be resolved, however, this will take time because these SOQs are written into contracts and are legally binding. Again these contracts extend past the October 2008 proposed implementation date, which potentially leaves the downstream community in a difficult position. Most of the very large changes are to interruptible customers where their SOQs imply a very low Load Factor, which isn't necessarily the case. With the imminent changes to the interruption regime under MOD 90 might it not be better to leave the existing arrangements in place for interruptible supplies?

C5, Q1: Can respondents identify additional significant unintended consequences?

In your assessment you have indicated the financial impacts to the end user. You have assumed that these changes will or indeed can be passed on. TGP would highlight that this is not necessarily the case with a large number of customers who remain on fixed price contracts that often extend well past October 2008. Whilst it may be considered that this is simply a redistribution of charges, at an industry wide level, this is true (subject to the issue highlighted in C3, Q1), but at a shipper's/supplier's portfolio level and an individual end users level, this is not true. This is potentially damaging to both suppliers/shippers and end users where fixed price contracts are in place.

A second consequence relates to sites which are vacant. Where the site is vacant, the shipper may be left stranded with transportation charges in effect twice what they are under the existing arrangement.

C6, Q1: Do respondents agree that we have identified all relevant costs and benefits?

TGP considers that there would be additional costs associated with this change. TGP considers that we would have to amend our pricing quotation systems, and would probably need to review some of our current products. We would also need to review our contractual terms and conditions and would need to conduct a review our internal processes, policies and risk assessments in areas such as vacant sites and on the AQ review process.
We believe this to be in the region of £100,000.

To conclude, TGP believes that:

1. the proposal, if implemented, should either be delayed to at least October 2009 to allow shippers and suppliers to align their contractual obligations with the end users, or be implemented through a phased approach.
2. That interruptible supply points should be exempt from this change and the current position maintained until the implementation of MOD 90 in 2011.
3. That if the reason for this implementation is stability, then the concept of spreading out any under /over recoveries over a greater period of time should be considered. Changing prices twice a year is unnecessary as it places too much of an administration burden on the shipper/supplier. (see earlier point about disallowing 2 changes a year)
4. TGP remain to be convinced that the change should be as far as 95:5 and would support further investigation into the allocation of costs between the fixed capacity and variable commodity elements.

Yours sincerely

Richard Dutton
Special Projects Manager