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John McNamara
Gas Distribution Policy Team
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23 November 2007

Dear John,

DNPC03 - LDZ System Charges Capacity Commodity Split and Interruptible Discounts - Draft Impact Assessment

I am writing in response to the above consultation and attach our detailed response. For the avoidance of doubt, this response may be placed in the public domain. If you have any queries or require further clarification please contact Steven J Edwards, Head of Income & Pricing on 029 2027 8836 or Steven.J.Edwards@wwutilities.co.uk.

Yours sincerely,

Bob Westlake
Head of Regulation
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WALES&WEST UTILITIES

DNPC03 – LDZ System Charges Capacity Commodity Split and Interruptible Discounts – Draft Impact Assessment

Summary

In general terms, we are in agreement with the conclusions reached in this impact assessment that the proposed 95/5 % split of capacity/commodity charges will bring significant benefits including a more efficient use of network assets and more stable distribution charges. We also believe 95/5 % is more reflective of the costs we incur. Furthermore, the removal of the volume driver from Allowed Revenue with the move to a 95/5 % split should have the benefit of reducing the year on year variability of charge levels as a result of differences between actual and forecast throughput variations.

Response to Questions

CHAPTER 2 KEY ISSUES

Question 1: What are respondent's views on our assessment of the proposal against the objectives of the distribution charging methodology?

Objective 1

To reflect the costs incurred by the licensee in operating its transportation business

Licence obligations for a Gas Distribution Network licence holder include the requirement to provide a safe and secure infrastructure that allows gas to flow safely and under 1 in 20 conditions to end consumers. The transporter does not influence the gas delivered into the system or the gas taken out of the system.

Whilst we are in agreement that some costs cannot be easily categorised between capacity and commodity there is little evidence to show that throughput is a major influence on the costs we incur. The two largest elements of expenditure which have not been categorised as either capacity or commodity in table 2.1 are Formula Rates and Indirect Costs. Formula rates are, to a large extent, based on the assets we have in the ground which are designed to ensure that the network can meet its 1 in 20 capacity requirements. There is little doubt that this cost is more capacity related than commodity related. It does not vary with throughput changes.

The total overheads and indirect costs of the business include Asset Management, Operations, Corporate and back office support to support the direct activities of Emergency, Repair, Maintain, Replace and Capacity Growth of the Network. Within the total business a relatively small proportion of direct operational costs are linked to Emergency first call response that could be linked to throughput. All other direct costs are linked to Repair, Maintain, Replace and Capacity of the network. If one was to attribute the indirect costs and overhead on a full cost basis to Commodity or Capacity the vast majority of overhead would logically be attributed to Capacity.

Objective 2

To take account of changes in the transportation business

It is highly likely that Allowed Revenue will have no throughput related volume driver. Once allowed revenue is set under the PCR process GDNs are entitled to collect this revenue on an annual basis from its customers. It is sensible to align the Collected Revenue framework with the Allowed Revenue regime. We do not think it is beneficial to the industry to have a misalignment of Allowed and Collected Revenue that has the potential to create variable and unstable charges year to year for our customers. We firmly believe that implementation of DNPC03 will provide better price stability and predictability for our customers. This must be beneficial to the gas industry as a whole.

Objective 3

To facilitate effective competition between shippers and suppliers

Unpredictable price changes cannot be beneficial to potential entrants to the gas industry and indeed could be a barrier to entry. We believe that DNPC03 will help remove this barrier.

Question 2: What are respondent's views on which elements of Use of System costs are related to system capacity, system throughput or neither?

Please refer to the response given to chapter 1 question 1 objective 1 above.

Question 3: What are respondent's views on how best to recover costs that are neither related to system capacity or system throughput?

If there are costs that are deemed to be neither related to system capacity nor system throughput it is our view that they should be recovered through System Capacity charges. The idea of introducing a fixed cost per customer would require significant system changes for all Industry participants. The impact of fixed costs per customer to shippers would be very similar to that of System Capacity charges.

CHAPTER 3 DISTRIBUTIONAL IMPACTS

Question 1: What are respondent's views on the methodology used to determine the distributional impacts of the proposal?

WWU have no alternative views to determine the distributional impacts of the proposal. The methodology is in line with the views set out in DNPC03 to which WWU was a co-author.

Question 2: Can respondents identify any additional distributional impacts that have not been included in our analysis?

WWU have not identified any additional distributional impacts to those included in the analysis.

Question 3: How do the respondents view the proposal as it relates to interruptible supply points?

The GDN joint proposal has proposed a mechanism with minimal costs to ensure that the total revenue collected from interruptible customers, and the effective discount that they receive is unchanged. From October 2011 it is intended that all loads will be firm. WWU believe the proposals in DNPC03 are reasonable in light of future industry developments.

CHAPTER 4 OTHER IMPACTS

Question 1: What are respondent's views on our analysis of the impacts that might result from implementation of the proposal?

WWU broadly support the analysis contained in the impact assessment.

Question 2: Do respondents have any additional information with regard to possible environmental impacts?

WWU do not have any additional information with regard to possible environmental impacts.

CHAPTER 5 UNINTENDED CONSEQUENCES

Question 1: Can respondents identify additional significant unintended consequences?

WWU have not identified any additional significant unintended consequences except that there is evidence that the AQ and SOQ information currently provided to GDNs by shippers could be improved. Increasing the proportion of charges to shippers based on SOQs will incentivise shippers not to over state AQs and SOQs. This should result in better industry information which should result in a more efficient use of network assets

Question 2: What analysis would respondents like to see with regard to bi-annual adjustments to charges?

It is unlikely that WWU would make bi-annual adjustments to charges. If DNPC03 is implemented from October 2008, we would hope that this would result in more predictable and stable charges. We would like to consider making annual changes in April of each year as opposed to October to align price changes with regulatory years.

CHAPTER 6 COST BENEFIT ANALYSIS

Question 1: Do respondents agree that we have identified all relevant costs and benefits?

We have not identified any other relevant costs or benefits. During the consultation period some shippers did comment on the potential benefits to them of more stable, predictable charges as a result of DNPC03.

Question 2: Do respondents believe that our quantification of costs and benefits is correct? Interested parties are requested to provide information about any costs and benefits they can identify, which will inform our final IA?

WWU have no reason to believe that your quantification of costs and benefits is not correct.