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23<sup>rd</sup> June 2014

## **WWU response to Ofgem consultation on modifying NG's connection charging methodology in respect of Advanced Reservation of Capacity Agreements (ARCAs)**

Dear Jacob,

### **Question 1. Do you agree with NGGD's proposed change to the conditions for an ARCA. If not could you please provide reasons why you disagree with the proposal.**

Wales & West Utilities agrees with the proposed change to introduce an additional threshold of £500,000 so that an ARCA is required if the load is above 586GWh or over £500k of specific reinforcement is required. We note that while the Uniform Network Code generally sets thresholds in terms of annual quantity, other thresholds in transporters' Condition 4B statement, for example the threshold for Sufficiently Complex Jobs, are expressed in monetary terms. The rationale for an ARCA is that it protects existing customers if no shipper books exit capacity for the new connection which would require the existing customers to fund the shortfall in transportation revenue. For both these reasons we believe that a monetary threshold is appropriate and that £500,000 is a reasonable limit that protects existing customers while still keeping ARCAs for unusually large connections. Since 2005 WWU has required one ARCA under current rules and would not have required any additional ARCAs had this new proposed rule had been in force since 2005.

WWU believes that the downstream transporter should be able to require an ARCA in the following circumstances:

- Where either it or an upstream transporter is required to reinforce and the combined cost of the reinforcement exceeds £500,000. It should be noted that the downstream transporter may be exposed to transmission exit costs for several years but will only be protected for one year by an ARCA. This risk will be increased by the implementation of UNC modification proposal 452 -Introduction of the Planning and Advanced Reservation of Capacity Agreement (PARCA) which is currently awaiting a decision by Ofgem, this is discussed further below.
- Where capacity is increased in stages and where the threshold is passed for each stage (this is effectively a linked series of ARCAs over a period of more than a year but it may be easier to write it as one agreement).

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**Question 2. Do you think that the proposed threshold of £500,000 for when an ARCA will be required is justified? (or is it too high or too low?)**

As stated above we think that £500000 is an appropriate threshold.

We also wish to raise the wider issue of balancing the risk between existing GDN customers and new customers or those seeking increased capacity.

We note the comments in paragraph seven of Ofgem's letter

"The ARCA offers protection to the GDN's existing customers against having to pay for reinforcement work for very large new loads that may not be used. It ensures that the party requiring the large new load (or increase in existing load) bears the risk of the increased capacity not being used"

In December 2002 Ofgem issued a determination using its powers under Gas Act sections 21 and 27A in relation to the proposed connection at Langage Energy Park. Paragraph 2.19 of this document stated:

"In 1997, Ofgas circulated its conclusions on ARCAs [A report on Agreements made pursuant to the Network Code, including Advanced Reservation of Capacity Arrangements (ARCAs) Ofgas October 1997]. It concluded that ARCAs are only suitable in limited circumstances, namely if Transco can demonstrate that a particular load is riskier than the overall portfolio of firm loads. It further concluded that commitment beyond one year is not normally appropriate, as the network code only requires capacity to be booked on an annual basis. ARCAs are only available (indeed Transco requires them) for new firm loads with a peak supply of 0.5Mcm/d or greater where specific system reinforcement has been identified as being necessary to meet the specific load requirements"

The impact of limiting ARCAs to one year is that it limits the protection for GDN's existing customers against having to pay higher transportation charges for reinforcement work for very large new loads that may not be used after the first year. If reinforcement is done for a new or increased load then if this capacity is not taken up the GDN's existing customers will be paying for this for the next 45 years; therefore these customers are exposed to the risk for a considerable period. Ofgem's current minded to position on the NGGD proposal which refers to the risk that the capacity may not be used therefore seems to recognise that the risk to existing customers extends for more than one year and may suggest that ARCAs that last for more than one year may be appropriate.

In addition, as a result of a new large connection (or increase in capacity) the DN may need to to apply for increased firm capacity on the National Transmission System. As a result of the reform of interruption arrangements in 2011 distribution networks have to enter into a User Commitment of four years for any additional NTS Exit Capacity that they may require as a result of a new connection or capacity increase. If UNC modification 452V is approved by Ofgem then the DN may be subject to a PARCA and to make further commitments beyond the four years. If the DN is limited to one year ARCAs then its existing customers are exposed to the risk of the new connection not using the capacity on the NTS. This risk did not exist at the time of the Langage determination and the Langage determination specifically referred to the network code only requiring capacity to be booked on an annual basis.

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In addition the move to RIIO price control in 2013 introduced a change from straight line depreciation to "sum of the digits" depreciation which means more of the depreciation is incurred in the earlier years. This means that now 4.3% of the depreciation is incurred in each of years 1 and 2 compared with 2.2% under straight line depreciation. This means that if the new capacity is not utilised in year 2 onwards the immediate impact on transportation charges is now about double what it was previously and therefore has a larger effect on existing customers.

Given the changes described above we believe that there is a good argument that existing customers should have increased protection from the failure of a new customer to use the capacity and therefore that it is appropriate for ARCAs to be for more than one year.

We therefore invite Ofgem to comment on whether it is now appropriate for ARCAs to be for more than one year.

Yours sincerely



Steve Edwards  
Head of Regulation  
Wales & West Utilities

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