Julian Majdanski
On behalf of the DN Transporters
Joint Office of Gas Transporters
Ground Floor Red
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28th August 2007

Dear Julian,

Re: Distribution Networks Pricing Consultation Paper DNPC03

Corona Energy ("Corona") wishes to submit the following in response to the above proposal.

Corona remains unconvinced by the information provided that a move to a 95:5 Capacity/Commodity split would be more cost-reflective than the current balance of charges.

a) Should the Charging Methodology be changed so that the capacity element of the LDZ charges is set to recover 95% of the revenue from the LDZ system charges, and the commodity element is set to recover 5% of the revenue, compared with the current 50/50 target split?

In our response to DNPD02 Corona highlighted the fact that in previous discussions (in 1996/97) a proposed move to a 90:10 split was rejected by Ofgas. Ofgas commented at the time that although there were certain costs which could be easily allocated to fixed and variable "buckets", there was at the same time a significant pot of other costs which could not be allocated to either group with any degree of certainty. In particular Ofgas commented that; " if you assumed commodity charges were driven by gas flows they should include a large proportion of staffing costs, metering, shrinkage, emergencies, administration and offices etc…" As stated in our earlier response it is unclear that of the 95% of capacity and indirect costs, how much is actually indirect and, of that, which can properly be classified as fixed.

Corona challenged the DNs to breakdown the cost categories provided in DNPD02 to allow the industry the opportunity to review the proposed allocation and comment on the validity of a 95:5 balance. We appreciate that the DNs have attempted to meet this request. However, we remain unconvinced that the information presented supports the 95/5 split proposal. Our first observation is that the Table 3.1 contained within the Proposal aggregates a category classified as "Other Net Overheads". This aggregation does not assist the reader in identifying whether these costs can legitimately be classified as fixed or variable costs. Corona requests that this category is broken down further to permit the industry the opportunity to consider the proposed allocation.

Secondly, we are not convinced that the remaining categories listed under Indirect Costs should qualify as capacity related charges. If we consider what the application of charges actually means, we must conclude that those customers with a lower load factor should pay **proportionately** higher contributions to, for example Formula Rates. This does not seem reasonable. There is not a direct link between the basis on which the DNs incur the costs and the basis by which they then pass them on. It is our opinion that charges to the User, which are supply point linked should be seen to be fair and equitable and we challenge the DNs to explain why capacity charges should be seen as a the appropriate mechanism for recovering these costs. In effect, the DNs are arguing that pipeline capacity is an appropriate cost driver for the recovery of, in our example Formula Rates. Corona does not believe that this linkage is sustainable. Indeed we would go further and claim that it is not cost reflective.

Indirect costs cannot be wholly tied to capacity holdings and should, at best be shared across a combination of capacity and commodity charges.

If we extend this approach and assume that all of the indirect costs are indeed indirect (subject to our request for further investigations into Net Overheads) and that they would be more reasonably split between capacity and commodity elements, we might conclude that a fairer split would be 79:21.

b) Should interruptible supply points pay 47.37% of the increased LDZ capacity charge so as to maintain the value of the discount received by interruptible supply points at its current levels, on average?

Notwithstanding our general critique of the proposed 95:5 split, Corona believes that the imposition of an uplift to interruptible charges during the period up to the introduction of the Mod 0090 arrangements is reasonable. However we note that statements made in the DNP02 Report appear to back-up the arguments we have raised in this response. It is telling that the DNs admit that "In addition a high proportion of indirect costs will be recovered through the capacity charges and interruptibles contribute as much as other supply points to these costs". We can only conclude that capacity charges are **not** a reasonable basis for the recovery of certain assumed fixed costs as the DNs admit that certain indirect costs cannot be fairly recovered via capacity charges. Again we challenge the DNs to explain why they have elected to treat interruptibles in this way whilst claiming that the indirect costs they have identified should be more generally recovered via capacity charges?

c) Should this change be made with effect from 1st April 2008 or 1st October 2008?

Again, Corona can only reiterate observations made previously. Clearly, we remain unconvinced that the introduction of the change will further the Licence Objectives, and for this reason we believe that it is premature to consider implementation of any move towards capacity bias charging.

However, we are keen to explain our overall concerns with regards the implementation of this, or any other change to the charging methodology in the event that such a change is permitted.

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Corona believes that neither date is acceptable for a variety of reasons, key amongst them being; data quality and customer/supplier contract negotiations.

In terms of data quality, clearly any moves towards capacity bias charging will place greater onus on the robustness of SOQ information. This is a particular problem for interruptibles where historically the significance of this data item has been limited. This is certainly borne out by the peculiar results represented in Appendix 1 of the Proposal. We would go further and claim that Appendix 1 throws up a number of peculiarities with each DN displaying very different impacts on similar customer types. Corona believes that the impact analysis provided by the DNs serves to underline that data quality is far from perfect and the industry needs to be provided with a reasonable period of time to ensure that it is improved. Clearly, in the event that these pricing changes are introduced prematurely then a number of customers are likely to suffer undesirable consequences.

The issue of customer/supplier contracts should not be underestimated. The majority of customers in the I&C market tend to enter into annual supply contracts commencing at the start of each Gas Year. Negotiations of these contracts will start much earlier in the Calendar Year. Traditionally, I&C customers have resisted fixed charges and have a strong preference for volume based charges which when operated in parallel with capacity bias transportation charges will impose significant risks on those shippers operating in these markets. As a result, it is imperative that the market is provided with an appropriate period of time to consider future methodology changes so that suppliers can negotiate effectively with customers and investigate various risk mitigation tools.

Corona proposes that in order to give the industry time to remedy ongoing data issues and to communicate, cooperate and negotiate with customers, changes to the current methodology (the desirability of which we question in any event) should not be effected until 1st April 2009, at the earliest.

As a general comment on the proposal, it is unclear to Corona why Ofgem, as perceived customer and energy efficiency champion, would want to approve increased fixed charges into the UK energy market. It could be argued that, increasing fixed charges in the supply chain may act as a disincentive for energy efficiency measures.

We trust you find our comments useful and if you have any questions then please do not hesitate to get in touch.

Yours sincerely

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