RWE npower

Joint Office of Gas Transporters
Ground Floor Red
51 Homer Road
Solihull
West Midlands
B91 3QJ

Your ref
Our ref
Name Stephen Rose
Phone 01793 892068
Fax 01793 892981
E-Mail stephen.rose@rwenpower.com

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DISTRIBUTION NETWORKS PRICING CONSULTATION PAPER DNPC03: LDZ System Charges - Capacity / Commodity Split and Interruptible Discounts

Dear Sirs,

RWE npower welcomes the opportunity to comment on the above consultation paper and does so on behalf of all its licensed gas supply businesses. I would be grateful if you would forward our comments on to the relevant persons within each of the Distribution Networks (DNs).

Should the charging methodology be changed so that the capacity element of the LDZ system 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 to the current 50%/50% target split?

Based on the evidence provided by DNs it is hard for us to dispute the fact that 95% of DNs costs would appear to be insensitive to the level of system throughput and that moving to a capacity/commodity split of 95%/5% appears to be most cost reflective. To this extent if Ofgem, who have access to far more detailed information on DN costs breakdowns than we do, are convinced this analysis is accurate and robust we would support changing the charging methodology to reflect this at an appropriate time.

We note that under current DN invoicing arrangements the capacity invoice is currently paid about 4 days earlier than the commodity invoice. A change to the capacity/commodity split will result in windfall cashflow benefits to DNs which could be significant, and we would expect DNs to take steps to redress this unintended impact should the change be implemented.

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 level, on average?

As previously stated we do not support this proposal as individual interruptible customers will experience very different changes to their charges depending on their load factor and the LDZ Exit Zone in which they are located. Those in expensive LDZ Exit Zones and/or with higher load factors than average will be worse off as a result of applying a standard 52.6% capacity discount compared to those in cheaper LDZ Exit Zones and/or with lower than average load factors. Also, within the same load bands interruptible customers with the same load factor could experience very different changes to their charges. This is demonstrated in

RWE npower
Trigonos
Windmill Hill Business Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

T +44(0)1793/87 77 77
F +44(0)1793/89 25 25
I www.rwenpower.com

Appendix 1 where an interruptible customer in Scotland using between 10m and 50m therms p.a. with a 42% load factor would see a ~31% reduction in charges whereas a similar customer in West Midlands would see a ~2% increase.

Whilst DNs defend implementation of an interim solution by relying on the fact that the changes are neutral to the interruptible sector as a whole they are not the ones who will have to explain the disproportional and potentially discriminatory impact this will have to customers. Suppliers are the ones that will be faced with this onerous task. Suppliers will also have to re-educate LDZ interruptible customers that despite having received 100% relief from capacity charges for over twenty years they will now have to pay a contribution, albeit at a reduced rate.

If this interim solution were to be adopted it is not clear to us whether the level of capacity and commodity charges will be set based on the total amount of firm and interruptible capacity or the total amount of capacity on which charges will be levied.

Nor is it clear whether xoserve, on behalf of DNs, will create a separate charge code for interruptible LDZ capacity charges or whether they will apply a different rate using the existing charge code. As this is still being investigated by xoserve it is not possible to say what impact this will have on shippers invoice reconciliation and billing systems, but if changes are required this is a strong argument against early implementation of this interim solution.

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

We do not believe it is appropriate for DNs to move to a 95%/5% capacity/commodity split with effect from 1st April 2008 or 1st October 2008. Ofgem's previous statements on this issue have indicated that any such change should be introduced alongside DN interruption reforms, which suppliers and end user customers have interpreted as meaning on expiry of transitional arrangements. However, if Ofgem's impact assessment concludes that the benefits significantly outweigh the costs and disproportional effects arising from this proposal it may be appropriate to make the change earlier than October 2011, or to consider a phased introduction up to that date.

In our opinion the earliest such a change should take effect is October 2009, although if Ofgem's proposal to amend the DN licence condition to allow changes to transportation prices biannually is implemented, there may be a case for implementing such a change from April 2009.

Whist a change in capacity/commodity split will not in its own right lead to the introduction of standing charges to domestic customers it, combined with the increased divergence in transportation charges across the DNs, is likely to result in a number of suppliers re-evaluating their tariff structures in light of the fact that the risk of a disconnect between tariff revenue and transportation costs has undoubtedly increased. Bearing in mind the focus in energy policy towards achieving demand management and environmental goals it would be unfortunate if undue haste in implementing this proposal, and its potential impact on the level and structure of supplier tariffs, were to prematurely compromise the burgeoning attempts by suppliers to incentivise demand management and energy efficiency.

Whilst suppliers value stability of transportation charges predictability is equally, if not more, important. To this extent we have raised Modification Proposal 160 which, if implemented, will provide shippers with appropriate information with which to predict the likely direction and magnitude of future changes to DN transportation charges. Bearing in mind measures have already been taken to enhance stability in the form of changes to the structure of LDZ customer charges and that further measures are under consideration as part of Ofgem's ongoing Gas Distribution Price Control Review (such as removing the throughput revenue driver and changes to the correction mechanism), any stability benefits attributable from a change in the capacity/commodity split will be low, particularly as the largest changes to DN transportation charges seen over recent years have been as a result of changes not connected with variation in throughput driven by weather but by such factors as mains replacement, rates and P0 charges between price controls. If Ofgem were to be convinced of the merits of this proposal we do not think that any supposed stability benefits make it imperative that it should be implemented straight away. Bearing in mind the capacity/commodity split appears to have been unreflective of DN costs for some considerable time without causing any significant investment inefficiency, we see no imperative in changing it hastily.

Issues surrounding the change in the capacity/commodity split should not be divorced from the inadequacies of the current gas settlement systems and processes. To this extent, implementing any change on commencement of the enduring offtake arrangements should allow time to consider the impact of such a change on these settlement systems and processes, and to resolve some of these inadequacies. For example, the AQ Review process, which ultimately determines the basis on which shippers are charged NDM DN transportation charges, is an annual process and one which precludes shippers making changes to an NDM AQ if the change is less than or greater than 20% of the DNs provisional figure. If the capacity charging component were to increase this would increase shippers exposure to cost over/under recovery and it may be appropriate to reconsider this rule in light of such a change. Also capacity is not currently reconciled under the Reconciliation by Difference/AQ Review processes and similarly this situation may no longer be appropriate in the event the capacity/commodity split were to be changed to 95%/5%.

Should you wish to discuss our response in more detail please do not hesitate to contact me.

Yours faithfully,

Steve Rose
Economic Regulation

Sent by e-mail and therefore not signed