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Thursday, 10 May 2007

Dear Julian,

Re: Distribution Networks Pricing Consultation Paper (DNPC03)

Thank you for the opportunity to comment on the above pricing consultation paper. Statoil (UK) Ltd (STUK) is in support of changing the proportions of revenue recovered by the LDZ system charge to a more cost reflective 95% capacity 5% commodity split. In answer to the questions raised in the consultation paper STUK would like to make the following points:

a) 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 with the current 50%/50% target split?

Cost reflectivity

The consultation paper links fixed and variable costs to the capacity and commodity charge. STUK has contemplated the concept suggested of associating the fixed costs of a distribution network to the capacity charge and the variable costs to the commodity charge and in the context of a regulated Distribution Network there appears to be a logic to the new pricing structure. Unlike the Transmission Network, in a Distribution Network, all capacity is used for the purpose of supplying gas to end users. This simplifies the logic of charging all fixed LDZ system costs to end-users through the capacity charge.

The Distribution Networks have stated that their costs are split roughly 95 pct as fixed and 5 pct as variable and that therefore their capacity and commodity charges should be split on that basis. Previously a 50/50 split of capacity and commodity was considered more appropriate however with the withdrawing of the volume driver through the DNPCR process it would appear the argument for maintaining this split has now changed. The move towards a split of capacity and commodity more reflective of fixed and variable costs would therefore appear to be a logical step.

Questions have been raised regarding the appropriate allocation of Indirect Costs. Consideration of the high-level breakdown of the Direct and Indirect costs in the consultation paper suggests the majority of these costs do not vary with throughput and should therefore be considered fixed.

STUK would like to understand whether the fixed and variable costs may change over time and therefore whether capacity/commodity split is likely to require revising and if so when the structure should be revised.

<u>Effect of the Change on Prices</u>

The Distribution Networks have stated that one advantage of changing the split between capacity and commodity is that it will reduce the volatility of transportation charges.

It would be beneficial if the DNs could perform analysis to show how transportation charges would have been set and what the levels of changes would have been in the previous three/four years had the 95/5 split been used instead. This analysis could then be used to predict the likely impact if implemented. It seems likely that it would take a year or more for the effects of the current under/over recovery cycle to dissipate. This analysis should show if and how long this would take to happen.

<u>Reduction of Volatility in Revenue Collection</u>

Currently 50 pecent of the DN system charges are collected via the commodity charge. The revenue the charge collects is subject to changes in throughput which can vary considerably depending on the weather and other factors. Reducing the exposure of DN revenue to the changeable nature of the commodity charges should reduce the levels of under or over recovery which in turn should lead to a reduction in the levels of change seen in the DN charges between pricing periods.

The reduction in the variability in revenue collected will also reduce the variability in the DNs cash flow. Logically this reduction in the cash flow risk should also help reduce the cost of capital for the DNs.

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 level, on average?

The discussion paper raises the issue of the level of discount interruptible sites should receive prior to the introduction of any new interruption regime. STUK has considered the option suggested by the DNs in the consultation and the alternative suggestion raised during industry discussions regarding the suggested approach to the level of discount.

The option put forward by the Distribution Networks to maintain the existing overall level of discount offered to interruptible customers. Currently customers get a discount equal to the existing capacity charge. This discount was provided to compensate interruptible customers for the lack of firm capacity rights. The interruptible customer would still pay all other commodity and customer charges.

Under this proposal the existing level of discount would be maintained however the customer would pay the 45% of the costs moved from the commodity charge to the capacity charge. The net effect would be that the customer would pay 47.37% of the standard capacity charge and the 5% of the commodity charge. This solution would ensure neither firm or interruptible customers would be disadvantaged as a result of this proposed change.

The second option suggested by the MEUC is that the interruptible customers should continue to receive the benefit of a discount equal to the full capacity charge in recognition of their lack of firm capacity rights. Clearly if DNs recognise that the structure of LDZ system charges should reflect the higher cost of capacity provision (95% of the LDZ system costs) then there is an argument that they should also reflect the higher value of the service that allows them to restrict the capacity provided.

STUK recognise the logic in the option suggested by the MEUC and believe that this will ensure the charges reflect the full benefit these customers are providing to the distribution network by allowing their supply points to be interrupted.

<u>Affect on Shipper/Supplier Systems</u>

The affect of the DNs proposal on how to treat Interruptible sites will require some changes to Shipper/Suppliers systems in most cases. This is because most systems calculate the transportation charges the customer should/will pay and currently they are unlikely to account for varying the level of the capacity charge to be applied to interruptible customers. Statoil is currently investigating the nature and level of impact these changes will take.

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

Assuming the DNs proposal for the treatment of interruptible customers is accepted Statoil believes it would be beneficial to implement the proposal from 1st October 2008 which would provide enough notice of the system changes to Shippers and would have the added benefit of aligning the proposed changes with the implementation of UNC Modification 90. This would avoid making two rounds of changes to the interruptible supply points within 6 months.

In any event if the DNs proposal for the treatment of interruptible customers is accepted then at least 4 months is required for a shipper to make changes to its system and address any portfolio issues caused. If the MEUC proposal were to be accepted then the implementation date could be under the same timescales as any transportation charge change.

STUK trust that our comments will be given due consideration and should you wish to discuss any aspect of this response further please contact me on the above number.

Yours faithfully

Richard Street*
Statoil (UK) Ltd

**Please note as this letter has been delivered electronically this letter is unsigned*