

## Distribution Networks Pricing Consultation Paper DNPC04

### Methodology for Determining the Balance of Revenue recovery between LDZ System Charges and Customer Charges

Response on behalf of British Gas

British Gas is pleased to see that the Distribution Networks (DNs) are now taking the opportunity to update the proposed apportionment of revenue recovery between LDZ System and Customer charges, and we strongly support their proposals.

The proposed revisions represent simple and relatively small updates to existing parameters, and are not a change in the methodology itself. In the past these parameters have been reviewed on an annual basis without formal consultation. However since 2003 a review has not taken place, revision of these parameters is therefore overdue and the changes proposed should be implemented immediately.

We do not believe that the impacts of these changes are large enough to delay implementation beyond 1<sup>st</sup> April 2009. Changes of a similar scale have been made in the past. Nevertheless, the impact of the difference between the present application of the LDZ system / customer split is sufficiently material to warrant change.

Presently there is a difference between the apportionment set out and recommended further to previous analysis (PD16 2003 71.8%:28.2%) and that presently applied, at least in general terms by the network owners (70:30). The application of this "rounding" appears somewhat arbitrary given such rounding was not been widely discussed or consulted upon. The effect of the present customer/system split and practice to "round down" to 70:30, as well as reducing present cost reflectivity today, is to exaggerate the impact of the move from what was set out in 2003 (71.8:28.2) to that proposed in the future (74.4:25.6). As a matter of urgency, and irrespective of this consultation process, we would ask that network owners amend their practices such that their application of the charging methodology at least moves towards the 71.8%:28.2%.

The primary charging methodology objective requires that "charges ... reflect the costs incurred by the licensee in its transportation business". The analysis carried out by the DN's demonstrates that current charges are not cost reflective, and should therefore be updated as soon as possible. There are no systems or process issues to prevent implementation at the earliest opportunity, in April 2009.

We note that the proposals may result in an increase in charges to Independent Gas Transporters. However, updating the parameters will simply remove any distortions or subsidies applied to this group, and that only increases the urgency with which the proposals should be implemented.

#### Question 1

**Should the charging methodology be changed so that the balance between LDZ System charges and Customer charges for each DN is based upon a network-specific estimate of the split of relevant costs ?**

We agree that the charging methodology should be changed to reflect a network-specific estimate of relevant costs, as we believe this would be more cost reflective approach.

However, we would have no objection if other parties preferred a DN weighted average split, as across the board this would still be more cost reflective than using the current, out of date, parameters.

British Gas recognise the introduction of different parameters for different networks is a new consideration. However we do not believe the debate on this aspect should delay

implementation. For example parameters could be updated on a national basis on 1<sup>st</sup> April and then subsequently introduced on a geographical basis on some later date.

## Question 2

**Should the DNs rebalance the LDZ System and Customer each time the level of charges is changed or should DNs rebalance the LDZ System and Customer charges only if the forecast revenue split deviates from the cost-reflective target by more than a set threshold value, if so the DNs would welcome feedback as to whether the threshold should be set at +/- 1%, 2% or at another level ?**

We do not believe the DNs should set an arbitrary target because it is important that charges are cost reflective as per the DNs' licence obligations. A small percentage variance may have material impacts given the level of costs over which such percentages are applied. If a threshold was introduced it should be no greater than +/- 0.5%

It is also important that any threshold does not result in a general practice to apportion charges persistently in one direction, either plus or minus, as has been the case in the past.

## Question 3

**Is there any reason why the proposal should not be implemented from 1<sup>st</sup> April 2009 ?**

As discussed above, we do not believe there is any reason why the proposal should not be implemented from 1<sup>st</sup> April 2009. The impacts are not fundamental and we do not believe that any bedding-in period is required.

The parameters associated with the balance of system and customer charges used to be reviewed and amended on an annual basis, therefore there is clear precedent for these changes to be introduced according to the proposed timeline. For purposes of clarity we observe that this change has a comparatively minor impact upon the market when compared with those revisions made most recently to the capacity and commodity split.

The proposed revisions are also required to remove the distortions and cross-subsidies generated by out of date parameters, and it is therefore imperative that no further delay takes place in implementation.

We have some sympathy with the general argument that it is necessary to allow sufficient notice such that system changes can be made. However as we have previously highlighted these are only simple parameter changes. Given that similar changes have been made under similar lead times we do not believe it is reasonable for improvements in cost reflectivity to be delayed in order to countenance lack of foresight or understanding in the design of other parties' systems.

Further to the DCMF meeting on 27<sup>th</sup> October we note that some parties have put forward a number of arguments which appear to be merely seeking to avoid or delay the implementation of a methodology which is truly cost reflective. These range from arguing that

1. the parameter update are not material enough to warrant change, to
2. the parameter updates are material and not enough notice has been given and the changes should be delayed until 2010. (Even though this change was widely flagged in advance by the networks)

As the networks have provided evidence that the proposed changes will make their charges more cost reflective we believe this change should be implemented from 1<sup>st</sup> April 2009.