

4 November 2008

enquiries@gasgovernance.com

Ocean Park House, East Tyndall Street, Cardiff CF24 5GT
T 029 2090 8569 F 029 2025 7019

Dear Sir/Madam

DISTRIBUTION NETWORKS PRICING CONSULTATION PAPER DNPC04

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

Independent Pipelines Limited ("IPL") and Quadrant Pipelines Limited ("QPL") set out below and in Appendix 1 their joint response to the above consultation.

EXECUTIVE SUMMARY

Background

On the 7th October 2008 the Gas Distribution Network Operators ("GDNs") published a joint consultation paper (DNPC04) on a proposed change to the existing methodology for determining the balance of transportation revenue recovery between LDZ System Charge and Customer Charge components. It is now proposed that the apportionment of revenue recovery between LDZ System ("LDZ") and Customer Charges ("CC") within each DN should be updated to reflect of each DN's own costs. This will mean a different percentage split of the revenue recovered from LDZ System charges and Customer charges for each DN. In essence the modification proposal suggests that the current nationwide recovery of revenue used by GDNs of a 70:30 split of LDZ System Charges to CC should be replaced by a nationwide split of circa 75:25 or a proportion determined for each individual network operator.

IPL and QPL's Response

Independent Pipelines Limited ("IPL") and Quadrant Pipelines Limited ("QPL") oppose the modification. This is because:

1. The modification proposal is not derived from robust analysis despite the fact that the changes in the underlying assumptions significantly impact upon the LDZ / CC split determined in the analysis.
2. The lack of a robust analysis will create an unlawful margin squeeze. IGTs are a special category of customer. They are the *only* customer group which is not permitted to pass these costs on and yet GDNs have undertaken very little work to assess the impact on IGTs. The assumptions, if used, will create an unlawful margin squeeze on IGTs in respect of future projects.
3. Further issues at existing RPC sites will be created as a result of the margin squeeze. Specifically these are:
 - (i) a further tranche of new legacy sites which are contracted for under RPC but which are at variance with GDN all-the-way charges; and
 - (ii) the creation of still further shipper surcharges.
4. IGT incomes on existing projects will be adversely affected by the change, bringing with it the likelihood of a delay in migration from legacy to RPC charging.

5. We understand that GDNs are planning an additional and more far reaching item of work aimed at detailed cost allocation. We believe that it is not sensible to proceed on a piecemeal basis with this proposal given that a linked item of work is planned for the next 6 months;
6. The GDNs proposal reflects a location-specific sensitivity which is at odds with Ofgem's previous preference for a load-based approach. The CSEP methodology agreed between IGTs and Transco sought to recognise these locational issues but further work on refining it was abandoned by IGTs when Ofgem indicated that it wanted to preserve a non-location specific, more load related approach.
7. GDNs have not demonstrated that the changes "better" facilitate the relevant objectives.
8. We understand that shipper contracts cannot be amended in time to reflect the proposed implementation date.

Due to the negative impacts of the proposed methodology change upon IGTs and the questionable derivation of the underlying cost allocation, IPL and QPL strongly object to this proposed change in methodology.

NEXT STEPS

We will contact your office in the next few days to organise a convenient date to come in and talk with you concerning our response.

Yours sincerely



Russell Ward
Director of Legal and Regulatory Affairs

1. THE MODIFICATION IS NOT DERIVED FROM A ROBUST ANALYSIS

We believe that a robust analysis should have included:

- a demonstration of ABC costs;
- a clear exposition of the assumptions used and the sensitivity of the outcome to changes in those assumptions;
- what assumptions have been used are based on 1 year's costs only;
- the repex allowances are skewed in favour of LDZ charges. This is explained in more detail below;
- an appropriate analysis of shrinkage. We have explained this latter item in more detail below;

Repex allowances have been skewed in favour of LDZ charges

In the case of NG (at least), the repex allowance has been inappropriately skewed in favour of the LDZ component. This is at odds with the 2:1 ratio we would have expected. It was suggested by National Grid¹ that one of the factors driving the proposed change is the significant mains replacement programme being carried out by all of the GDNs.

Table 1 – Allowed Repex (prices are in £m)

Total Repex	East of England	London	North west	West Midlands	Northern	Scotland	Southern	Wales and West	Total
LTS	£1.00	£0.50	£0.50	£0.00	£36.50	£0.50	£18.00	£41.50	£98.50
Mains Reinforcement	£358.50	£332.50	£337.00	£253.50	£243.50	£164.50	£434.50	£195.00	£2,319.00
Services (excl risers)	£147.00	£103.50	£121.50	£92.00	£122.00	£81.50	£236.00	£115.50	£1,019.00
Riser	£9.00	£30.00	£8.00	£5.50	£5.50	£4.50	£20.00	£3.50	£86.00
Total	£515.50	£466.50	£467.00	£351.00	£407.50	£251.00	£708.50	£355.50	£3,522.50

Table 2 illustrates the Repex allowance for GDNs, as per the current price control. The price control allows each GDN a specific allowance for each category. This table uses information from the current price control for GDNs covering 2008-2013 (*The Gas Distribution Price-Control Review – Final Proposals Ref 285/07*). It shows the level of repex allowed for each cost category.

Table 3 – Illustrates how the allowed Repex can be split into LDZ and Customer Charges on a percentage and ratio basis.

% Repex split between LDZ System and Customer	East of England	London	North west	West Midlands	Northern	Scotland	Southern	Wales and West	Total
LDZ System	69.74%	71.38%	72.27%	72.22%	68.71%	65.74%	63.87%	66.53%	68.63%
Customer	30.26%	28.62%	27.73%	27.78%	31.29%	34.26%	36.13%	33.47%	31.37%
Ratio	2	2	3	3	2	2	2	2	2
Ratio (DNPC04)	5	4	4	5	2	2	2	1	3

Assumptions made: LTS and Mains Reinforcement are 100% LDZ System related. Services and Risers are 100% Customer related.

The analysis in Table 2, illustrates the allowed expenditure in the price control split by LDZ to CC as both a percentage and ratio. The split between LDZ and CC repex is approximately 2:1, yet in the modification proposals National Grid are showing a much higher figure i.e. 5:1.

If the ratios in the modification proposal were consistent with the ratios in the price control, there would be a significant swing in the split of allowable revenue apportioned to the LDZ moving to the CC. This swing would be in the region of 2% for the East of England.

Shrinkage / Odorant

¹ Meeting at Elexon 27th October 2008.

The treatment of shrinkage / odorant in the proposed methodology is to allocate all of the costs across the LDZ and none are attributable to the CC. This in essence assumes that all shrinkage occurs on the LDZ.

Table 3 – Proposed shrinkage for the gas year 2008/09 expressed as a percentage

Total Shrinkage	East of England	London	North west	West Midlands	Northern	Scotland	Southern	Wales and West	Average
Low Pressure	58.31%	58.12%	67.00%	68.21%	76.72%	64.91%	66.16%	74.51%	66.74%
Medium Pressure	7.20%	5.28%	3.35%	5.03%	5.34%	5.47%	5.57%	6.78%	5.50%
AGI	9.80%	7.24%	8.21%	8.65%	8.02%	9.19%	9.36%	14.21%	9.33%
Other	19.98%	25.44%	17.09%	14.69%	4.96%	13.83%	14.10%	0.27%	13.79%
Own Use of Gas	1.61%	1.37%	1.51%	1.21%	1.72%	2.43%	1.73%	1.53%	1.64%
Theft	3.10%	2.54%	2.85%	2.21%	3.24%	4.17%	3.07%	2.70%	2.99%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Estimated certain figures for Scotland and Southern as a breakdown was not included in the final LDZ shrinkage proposals for gas year 2008/09 for Scotia Gas

It is arguable that a large proportion of theft of gas would occur at the service level and approximately 80% of leakage occurs at the low pressure end of the incumbent's network². In our analysis, we have assumed that all shrinkage allowances are attributable to the LDZ, apart from at the low pressure system where we have assumed a 50/50 split between LDZ and CC.

Table 4 – Adjusted split of shrinkage between LDZ and CC

Total Shrinkage / Odorant	East of England	London	North west	West Midlands	Northern	Scotland	Southern	Wales and West	Average
LDZ System	1.90%	2.47%	2.26%	2.24%	2.42%	2.56%	2.27%	2.21%	2.29%
Customer	0.70%	0.93%	1.04%	1.06%	1.38%	1.14%	1.03%	1.19%	1.06%
Total Shrinkage / Odorant	2.60%	3.40%	3.30%	3.30%	3.80%	3.70%	3.30%	3.40%	3.35%

Assumed that all shrinkage except for 50% of the low pressure system is attributable to the LDZ

This analysis shows that a considerable proportion of shrinkage costs, approximately 1% of allowed revenue, could be attributed to the services and therefore customer charge on a GDNs network. This would reduce the allowed revenue associated with the LDZ and increase the allowed revenue associated with the CC.

We make this point for a particular reason. The key point about that shrinkage allocation is that, if corrected and combined with a connected repex approach (as discussed above), the re-balancing exercise appears unnecessary.

2. LACK OF A ROBUST ANALYSIS WILL CREATE AN UNLAWFUL MARGIN SQUEEZE

The effect of a lack of robust analysis will create an unlawful margin squeeze contrary to Chapter II of the Competition Act 1998 if the proposal is implemented.

GDNs are obliged to comply with the Competition Act 1998 in setting their LDZ Charges. In particular GDNs should have carried out an assessment of the stand-alone costs of a notional downstream distribution company as required under OFT 404a.

Margin squeeze

GDNs hold a dominant position (as defined by section 18(3) of the Competition Act 1998) within the GDNs LDZ in respect of the upstream market for connections of newly constructed gas networks into and use of the pre-existing distribution system. It is an established principle of competition law that a vertical margin squeeze by a dominant company may amount to an abuse of a dominant position that infringes Chapter II of the Competition Act 1998.³

A vertical margin squeeze can occur where a vertically integrated company is dominant in an upstream market and supplies a key input to non-vertically integrated companies that compete with it

² LDZ Shrinkage - Initial Proposals Gas Year 2008/09, by National Grid 1 July 2008

³ See, for example, *Napier Brown-British Sugar OJ [1988] L 284/41*, *Deutsche Telekom OJ [2003] L 263/9*, *Genzyme v Office of Fair Trading OFT Decision, 27 March 2003* and, most recently, *COMP/38.784 – Wanadoo España vs. Telefónica*.

in a downstream market. Ofgem has also recognised a similar situation exists with respect to DNOs and IDNOs.⁴ To quote Commission guidance:

"A price squeeze could be demonstrated by showing that the dominant company's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant company."

The ability of a company to impose a margin squeeze on a competitor in a downstream market will correlate with the proportion of the downstream competitor's costs that are accounted for by the essential input that is provided by the vertically integrated dominant company. Assuming that IGTs were as efficient as GDNs⁵, the DUoS charges levied by GDNs would represent considerably more than 60% of IGTs' costs arising from the provision of distribution services to any given site in the GDNs LDZ. GDNs are evidently therefore in a position to foreclose IGTs ability to compete by imposing onerous costs which squeeze IGTs margins.⁶

The existence of RPC increases the risk of margin squeeze.

The charges that IGTs such as IPL/QPL may levy on customers connected to their networks are determined under a Relative Price Control ("RPC"), whereby the total initial charge for an individual supply point is set equal to that which would be charged by the GDN itself. The share of the total charge that is attributed to the IGT is the difference between this total charge and the charge to the site boundary ("the CSEP charge"). The CSEP charge is influenced by the total site load. Changes to the CSEP charge follows the charges published by the GDNs whilst the IGT charge follows changes in the GDN's SSP charge subject to the fact that the IGT charge is not required to track the SSP charge if the latter exceeds the 5% +/- floor and ceiling imposed by RPC.

GDNs appear not to have known about their obligations under OFT 404a.

Indeed the GDNs have verbally confirmed that only very superficial analysis was undertaken to test the effect of the proposal of IGTs. This failure is especially significant given that whereas all other downstream customers affected by the charge may pass the costs on, IGTs are not permitted to do so and so are a special case. The risk of GDNs imposing a margin squeeze upon GDNs, such as IGTs, is increased by the RPC price control that is imposed upon IGTs under Standard Condition 1 of the IGT Licence. The effect of this condition is that the charges levied upon the suppliers of gas for distributing gas to their domestic end-users on their behalf by an IGT must be no higher than if the gas was distributed all the way by the GDN.

As the maximum price that an IGT can charge to customers in the downstream market (i.e. gas suppliers) is tied to the price charged by the GDN, the ability of IGTs and other GDNs to operate on the downstream market is absolutely linked to the costs imposed by GDNs and other GDNs for the distribution of gas to the boundary point - i.e. the allocation of costs by the GDN between the upstream market, which is not subject to competition, and the downstream market, where substitution is possible.

3. FURTHER ISSUES AT EXISTING RPC SITES WILL BE CREATED

Further tranche of Legacy sites

⁴ It is worth noting that in responding on 12 July 2007 to a Western Power Distribution plc consultation paper regarding DUoS Charges, Ofgem emphasised that:

"In general, IDNOs will be competing with DNOs to provide part of the service of distributing electricity...In doing so they will be dependent on services provided, on a monopoly or essential facility basis, by the DNO. In this context, it is vital that the DNO ensures that the charges for such essential services (use of the upstream network) are consistent with the requirements of competition law - such as avoiding 'margin squeeze'".

Those sentiments are also shared by Energywatch. In the same response noted above, Ofgem stated:

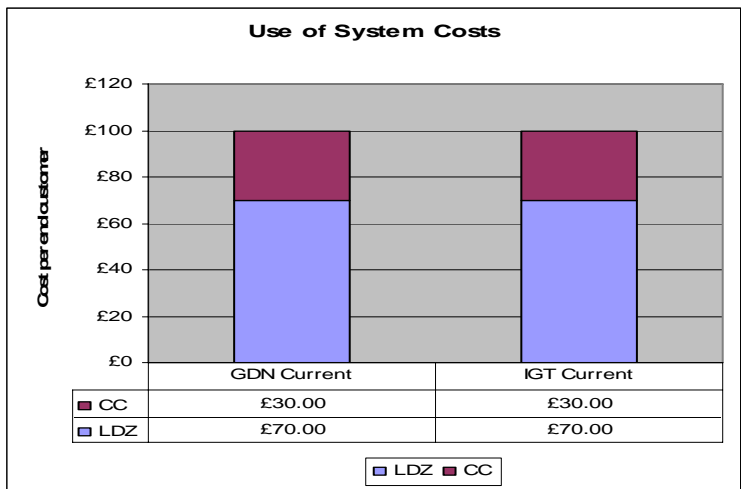
"Energywatch is concerned that if IDNO margins reduce this will threaten competition in connections".

⁵ Para 32, Notice on the application of the competition rules to access agreements in the telecommunications sector ("the Telecommunications Notice"), published in (1998) OJ C265/2.

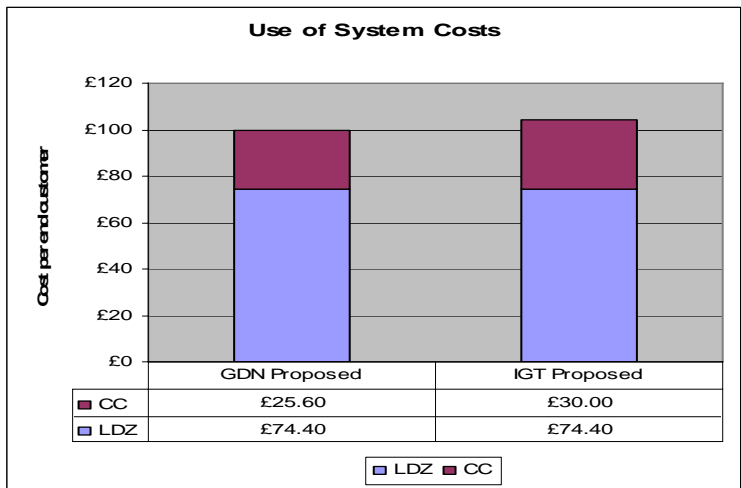
⁶ IGT's costs per connection are actually, inevitably, much higher at this stage in its development since it has a much smaller portfolio of properties over which to spread its non-direct costs.

For the GDN altering the split between system and customer charges results in a revenue neutral position for the income it receives overall from *all* the customers connected to its network but individual supply points will see changes in charges dependent on how their individual charges are recovered through the system/customer charge components.

This situation is illustrated below for a project with 1 property that has an existing all the way income (SSP) of £100. Currently approximately £70 of that income will be apportioned to the LDZ and £30 to the CC. In this instance the IGT charge is the equivalent of the CC and the CSEP charge is the equivalent of the LDZ.



The table below assumes that the new weighted average split has been approved. The LDZ (CSEP) will now become £74.40 and the CC (IGT Charge) will become £25.60 on a wholly owned GDN network, i.e. the all the way income remains at £100. This means that a further tranche of legacy sites will be created.



Going forward this situation will not be the case when an IGT supplies the last mile of network. RPC safeguards will ensure that the IGT is still able to charge £30 for its portion of the network, however the GDN will now be able to charge its new rate of £74.40 for its part. This means that the cost to the end customer has increased by £4.40 where an IGT supplies the last mile of network.

Shipper Surcharges

Currently many shippers apply a surcharge to customers that are on networks where the IGT displaces the GDN. They justify surcharges on the basis of increased costs of supplying the same

end customer if that customer is on an IGT network. If this modification proposal is not vetoed more customers upon IGT networks could be similarly disadvantaged as the number of surcharges is increased. This will adversely affect competition in supply as shippers will need to amend their pricing systems to cater for the different transportation charges.

4. DELAY OF MIGRATION FROM LEGACY TO RPC CHARGING

The modification proposal will delay the date that the IGT portfolio of Legacy projects would migrate into RPC. As stated earlier the existing IGT portfolio of Legacy projects is due to migrate to RPC charging at a point in time that would render the transition 'revenue neutral' for the IGT.

The impact of approving the modification proposal would be to reduce existing IGT incomes so that the point in the future when there is convergence of Legacy and RPC to achieve revenue neutrality would be delayed.

As shown in Table 5 below, the modification proposal will significantly reduce IGT charges from existing levels in all GDN areas except London. The reduction is greatest on smallest sites (below 73200 kWh per annum). The reduction in most zones is between 20 and 30%. For medium sized sites (between 73,200 and 732,000 kWh) the reduction ranges between 2% and 24%. For the largest sites (over 732,000 kWh) the reductions range from 1-10%.

In some areas an IGT would no longer consider obtaining a network as the incomes available would no longer offer a sufficient margin to operate and maintain the network and provide a suitable return on capital employed.⁷

The change would act as a barrier to the facilitation of competition in gas distribution and would have a significant impact upon an IGT's ability to finance its activities in an increasingly difficult market.

⁷ IGTs fund the purchase, operation and maintenance, cost of capital and other business costs of their networks from the cash flows that they are able to obtain from those networks.

Table 5 – Illustration of current IGT income in comparison to proposed IGT income

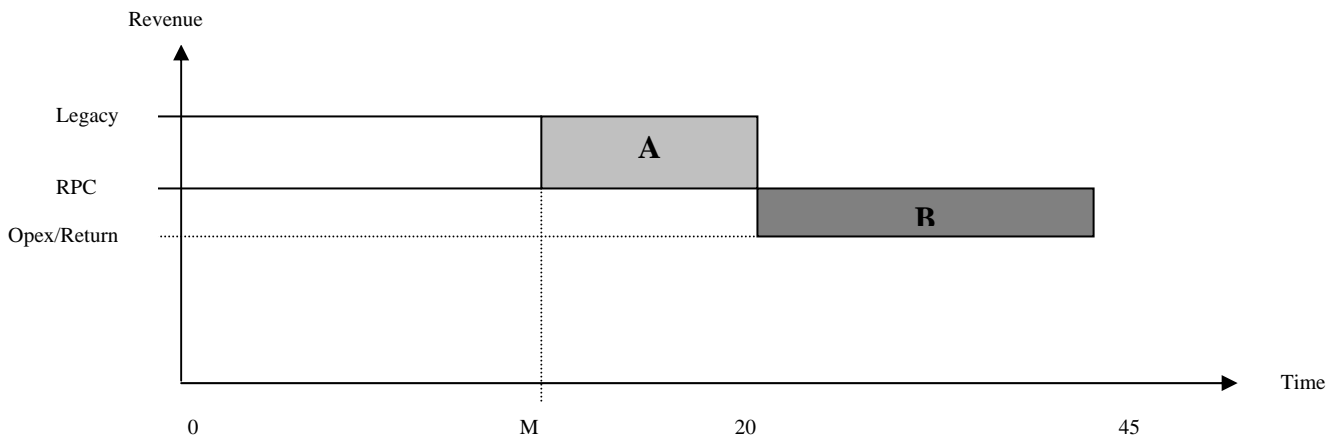
Exit Zone	Band	No Properties	Site AQ	Site SOQ	Current Net income £ per plot	Estimated Net income £ per plot post mod	% difference
EA	D	4	58444	478	£32.75	£26.07	-20.4
EA	D	10	146110	1195	£37.70	£31.40	-16.7
EA	D	45	657495	5377	£37.70	£31.40	-16.7
EA	D	100	1461100	11949	£49.72	£44.30	-10.9
EA	D	500	7305500	59746	£63.56	£59.21	-6.8
EM	D	4	58444	440	£30.15	£23.97	-20.5
EM	D	10	146110	1100	£34.71	£28.89	-16.8
EM	D	45	657495	4949	£34.71	£28.89	-16.8
EM	D	100	1461100	10997	£45.05	£39.98	-11.3
EM	D	500	7305500	54986	£58.05	£53.99	-7.0
NE	D	4	58444	436	£29.94	£28.06	-6.3
NE	D	10	146110	1091	£33.90	£32.12	-5.2
NE	D	45	657495	4908	£33.90	£32.12	-5.2
NE	D	100	1461100	10907	£42.41	£40.85	-3.7
NE	D	500	7305500	54537	£53.36	£52.08	-2.4
NO	D	4	63484	516	£35.42	£33.20	-6.3
NO	D	10	158710	1290	£40.08	£37.99	-5.2
NO	D	45	714195	5806	£40.08	£37.99	-5.2
NO	D	100	1587100	12903	£51.64	£49.84	-3.5
NO	D	500	7935500	64514	£64.11	£62.65	-2.3
NT	D	4	57392	474	£27.87	£30.09	8.0
NT	D	10	143480	1184	£32.43	£34.45	6.3
NT	D	45	645660	5328	£32.43	£34.45	6.3
NT	D	100	1434800	11840	£42.94	£44.68	4.0
NT	D	500	7174000	59201	£55.33	£56.72	2.5
NW	D	4	58444	436	£29.18	£21.18	-27.4
NW	D	10	146110	1091	£33.50	£25.95	-22.5
NW	D	45	657495	4908	£33.50	£26.01	-22.4
NW	D	100	1461100	10907	£43.25	£36.76	-15.0
NW	D	500	7305500	54537	£55.63	£50.47	-9.3
SC	D	4	63484	438	£30.62	£29.80	-2.7
SC	D	10	158710	1095	£34.63	£33.85	-2.2
SC	D	45	714195	4929	£34.63	£33.85	-2.2
SC	D	100	1587100	10953	£43.38	£42.71	-1.5
SC	D	500	7935500	54763	£54.60	£54.07	-1.0
SE	D	4	58444	497	£30.76	£26.35	-14.4
SE	D	10	146110	1243	£35.22	£31.07	-11.8
SE	D	45	657495	5594	£35.22	£31.18	-11.5
SE	D	100	1461100	12432	£46.31	£42.92	-7.3
SE	D	500	7305500	62159	£58.65	£55.97	-4.6
SO	D	4	57392	533	£32.98	£28.26	-14.3
SO	D	10	143480	1333	£37.73	£33.30	-11.7
SO	D	45	645660	5996	£37.73	£33.42	-11.4
SO	D	100	1434800	13325	£50.22	£46.64	-7.1
SO	D	500	7174000	66626	£63.21	£60.38	-4.5
SW	D	4	57392	491	£30.85	£24.22	-21.5
SW	D	10	143480	1228	£38.96	£32.96	-15.4
SW	D	45	645660	5528	£38.96	£32.96	-15.4
SW	D	100	1434800	12284	£46.89	£41.49	-11.5
SW	D	500	7174000	61421	£60.89	£56.57	-7.1
WM	D	4	58444	481	£27.07	£18.78	-30.6
WM	D	10	146110	1202	£31.43	£23.61	-24.9
WM	D	45	657495	5409	£31.43	£23.61	-24.9
WM	D	100	1461100	12021	£42.04	£35.35	-15.9
WM	D	500	7305500	60105	£54.25	£48.84	-10.0
WN	D	4	58444	436	£27.39	£21.47	-21.6
WN	D	10	146110	1091	£34.60	£29.24	-15.5
WN	D	45	657495	4908	£34.60	£29.24	-15.5
WN	D	100	1461100	10907	£40.62	£35.72	-12.1
WN	D	500	7305500	54537	£53.42	£49.50	-7.3
WS	D	4	57392	464	£29.12	£22.85	-21.5
WS	D	10	143480	1160	£36.78	£31.10	-15.4
WS	D	45	645660	5218	£36.78	£31.10	-15.4
WS	D	100	1434800	11596	£43.74	£38.59	-11.8
WS	D	500	7174000	57979	£57.13	£53.02	-7.2

How the migration date is calculated

The charges to Gas Shippers for most IGT Legacy Sites are, compared to the charges under RPC, “high” for the first 20 years of a Project. Where this approach is used this 20-year period may be thought of as the capital cost recovery period. The revenues then decline in a step function fashion to a lower level once the capital costs have been recouped under the methodologies. This step function approach differs from the Transco model where capital cost recovery is not explicit to each development project because capital costs are recovered across the portfolio as a whole. Under such an approach the profile is smoothed rather than following a step function.

To achieve this the higher revenues yet to be received from the pre-20 year projects (see area “A” in the diagram below) is surrendered in return for revenues under RPC (see area “B” below). Whilst the area B revenues follow a different profile, they are, nevertheless, equal in present value terms to the value foregone under A (i.e. it is ‘revenue neutral’). This is only possible because, although the

level of income under RPC is lower than under the methodologies during the capital cost recovery period, following the end of that period it is higher than would be the case had those methodologies continued in force.



From the above it is clear that, in calculating a different migration date, Ofgem will need to take account of: (i) the actual revenues earned by the IGT in applying the IGT's methodologies up to the review date; (ii) an updated assessment of IGT revenues from the date of the review to the envisaged migration date; (iii) the actual path of RPC revenues from Year 1 (Jan 2004) up to the date of the review, using the floor and ceilings calculated each year under the shadow charge approach. The floor and ceiling will be calculated by Ofgem on the review date at +/- 5% of the Transco equivalent charge which existed at January 2004; and (iv) an updated assessment of future RPC revenues. An updated assessment is needed since the Ofgem review might have changed the basis on which the future RPC revenues are calculated and therefore change the revenue line on which legacy sites migrate into RPC. Given the mathematical nature in which the revenue-neutral migration date is calculated, this approach suggests that (all things being equal):

- (i) If revenues at Legacy Sites are higher than forecast this will delay the migration date (assuming the revenues were legitimately higher). This is because the area under B must be made larger to balance the larger area under A (i.e. a greater area under B is needed to compensate for the higher revenues under A).
- (ii) If revenues at Legacy Sites are (legitimately) lower than forecast this will accelerate the migration date. Again this is because the quantum of income needed under RPC to compensate would not need to be as high.

Likewise;

- (iii) If RPC revenues are higher than forecast this will accelerate the migration (assuming no change in the Legacy Sites revenues).
- (iv) If RPC revenues are lower than forecast this will delay the migration date.

5. THE IMPACT OF AN ADDITIONAL AND MORE FAR REACHING COST ALLOCATION EXERCISE IN THE FUTURE

We have been informed by GDNs that they intend to carry out a different, but related item of work in the next 6 months or so, the object of which is to establish a more robust cost allocation than is currently used. If this is the case we contend that:

- (1) this implies that the allocation used to the current proposal cannot be said to be robust
- (2) it would (at the very least) be appropriate to defer this proposal until that work has been done.

6. LOCATION SPECIFIC SENSITIVITY

The volume of assets per customer and costs associated with operational activities depend on geographic and legacy network conditions. This is at odds with Ofgem's preference for avoiding a geographic charging pattern.

Indeed, it is noticeable that the London LDZ network (which may be expected to have the highest densities per length of main) shows a proposed revised split of 68.4% for LDZ and 31.6% for CC if changed, compared with 70.4% and 29.6% if left unchanged.

If GDNs are now proposing to reflect geographical factors in their charges we believe that there is a strong case for re-visiting the CSEP methodology agreed above IGTs and Transco 6 years ago.

7. BETTER REFLECTS THE RELEVANT OBJECTIVES

It is disappointing that the actual relevant objective test, the one which refers to "better" meeting those objectives has been omitted from the GDN consultation paper. The precise obligation on GDNs as regards their duty to review is to "better" facilitate the relevant objectives. We understand that GDNs have indicated that they are unable to verify whether the proposal better reflects the cost allocations previously used. This is because they are unable to access previous cost data since the date of sale in 2005. We believe that this therefore, demonstrates a case for delaying implementation until further cost analysis can be obtained.

8. SHIPPER CONTRACTS CANNOT BE AMENDED IN TIME

Shipper contracts cannot be amended in time. We understand that large I&C sites are contracted for on the basis of long term contracts which require 12 months or more notice to change. We believe that, even if none of the other points in this response were to apply (and we would strongly dispute such an assertion), such a situation unnecessarily disadvantages those suppliers contracted under such notice periods.

RW

APPENDIX 1

RESPONSES TO SPECIFIC QUESTIONS RAISED IN THE CONSULTATION

In the modification proposal the GDNs have raised three questions. The questions and the views of IPL and QPL are outlined below:

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?

No.

Our analysis of the proposed modification proposal shows that IGTs and end customers on IGT networks will be adversely affected by the proposed change. There will be a significant reduction in IGT incomes on future projects. There could be increased charges for existing customers on IGT networks over and above those experienced by like customers connected to the GDN with the possibility of more shipper surcharges on end customers on IGT networks. The planned movement from Legacy to RPC charging regimes could be delayed. In addition there are concerns over the suitability of the way GDNs have allocated costs between the LDZ and CC.

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 split 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.

No.

This would have significant impacts upon the stability of charges. Stability is a key issue for shippers in determining final prices to end customers and for IGTs in making long term investment decisions. It would be more acceptable for a review to be carried out every 5 years. This would bring any potential for change in line with changes to the price control. This would enable IGTs to plan future investments more effectively. Increasing the number of price changes would increase the administrative burden faced by IGTs when carrying out investment appraisals.

3. Is there any reason why the proposal should not be implemented from 1st April 2009?

Yes.

A full impact analysis has not been carried out which identifies all of the implications such a proposal would have on **all** stakeholders. We do not believe that the full impact of the change on the IGTs and customers connected to their networks has been properly established or quantified rather the analysis has been restricted to the impact on directly connected supply points off the GDN. We do not believe that shippers or the GDNs fully appreciate the effect of the change on IGTs or customers connected to IGT networks.