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Dear Sirs

Response to Distribution Networks Pricing Consultation Paper DNPC04 "Methodology for Determining the Balance of Revenue Recovery between LDZ System Charges and Customer Charges."

This letter is written in response to the above consultation submitted for and on behalf of all Gas Distribution Network Operators (DNs) published on 7 October 2008. These proposals have a significant impact on IGTs; therefore, we are disappointed:

- at the lack of sufficient transparency in explaining the rationale and justification behind the proposals;
- at the failure to undertake an impact assessment on the effects that the changes would have on shippers and IGTs;
- at the short period allowed by the consultation for responses; and at,
- the lack of engagement with IGTs on the proposals (given that, collectively, IGTs have circa 1 million end users connected to our distribution systems).

GTC **does not support** this proposal. In summary:

- The consultation fails to demonstrate whether DNs would more closely achieve "*the relevant methodology objectives*" through modifying the methodology in line with the proposed changes. In open meetings DNs commented that they have not done this because they do not have comparable data for earlier periods.
- The proposals are based on a single year's costs (2006/7). Established regulatory practice is to consider more broadly based data for a longer period (5 years minimum) and should look forward as well as backward.
- Implementing these proposals will reduce the revenues available to IGTs. Although DNs occupy a dominant position in the market, they have failed to

consider the impacts their proposals could have on competition. Specifically there is no analysis on whether the proposals will lead to margin squeeze.

- Shippers are likely to face higher transportation costs if DNOs implement their proposals. This is because, whist the IGT margins remain unchanged under the RPC arrangements, DNs will increase the CSEP price.
- In 2004, Ofgem confirmed in writing that, for legal reasons, Ofgem could not re-open IGTs' legacy migration arrangements. However, if implemented these proposals would lead to IGTs seeking to reopen migration dates and push them back even further than the current range of 2011 to 2020. It is hard to believe that Ofgem could contemplate this.
- Implementation of this change must, at the very least, be delayed until any further changes to the structure of LDZ system/ customer charges are known and can be assessed in conjunction with this current proposal (April 2010 at the earliest)

IGTs and shippers have worked hard to remove IGT surcharges. However, it is unacceptable that IGTs should expense higher DN revenues (from increased CSEP charges) at the expense of lower IGT margins. We believe that the DN proposals will have a detrimental impact on consumers; not vetoing the proposals would be counter to Ofgem's duty to protect consumers.

We will be happy to meet with any of the DNs to discuss further the points in this letter in more detail.

Yours sincerely

Paul Edwards
Shipper Services Manager
GTC

cc Ofgem

Annex 1

Detailed Comments to Distribution Networks Pricing Consultation Paper DNPC04 "Methodology for Determining the Balance of Revenue Recovery between LDZ System Charges and Customer Charges."

Impact of Proposals

1. DNs have a licence requirement to review their charging methodologies annually and, where appropriate, propose modifications that more closely achieve *"the relevant methodology objectives"*. The DNs, through their joint consultation, have failed to demonstrate why and how their proposals more closely achieve *"the relevant methodology objectives".* We believe that there are serious unintended consequences to IGT revenues should Ofgem choose to not veto the proposals.

2. The consultation fails to assess how proposed changes impact on IGTs, shippers, suppliers and end consumers. The short consultation period has meant that GTC has not had sufficient time in which to carry out a detailed assessment of the proposals. Nonetheless, our initial assessment suggests reduced IGT revenues of circa 23% in some cases. This is as a direct consequence of the proposed rebalancing. This is clearly an unacceptable outcome for GTC and presents serious implications under competition law.

3. Shippers are likely to face higher transportation costs if DNs implement their proposals. This is because DN proposals will result in higher CSEP charges. This is true in respect of metering points covered by the legacy portfolio arrangements and for metering points covered under RPC arrangements.

<u>Impacts to GTC "Legacy Portfolio"</u>

4. Special Condition 1 of the IGT licence came into force on 1 January 2004 and introduced relative price control (RPC) form of regulation for IGTs. As part of this, the Special Condition put in place cap and collar arrangements to counter (to a limited extent) DN prices changes that were at variance from the RPI. The RPC arrangements do not address issues such as DNs rebalancing the split between the LDZ and customer charges and consequential changes to CSEP charges.

5. In introducing Special Condition 1, Ofgem acknowledged that IGTs had already sunk investment into their existing portfolios. To address this, IGTs and Ofgem agreed migration arrangements whereby, at a point where "revenue neutrality" between the two charging regimes was achieved, the entire IGT "legacy" portfolio would migrate to RPC arrangements. The migration dates agreed with Ofgem ranged from 1st January 2004 to 1st January 2021 (as is the case for part of the GTC portfolio acquired through the purchase of Utility Grid Installations Limited).

6. The DN proposals will have a negative impact on revenues from IGT legacy portfolios. Cap and collar arrangements put in place under Special Condition 1,

mitigate against the impact of the proposals but only to a limited extent. In any case, these arrangements only apply up until 1st January 2014 (10 years from introduction of RPC). Therefore, for portfolio migration dates that are beyond 1st January 2014, the cap and collar arrangements will not apply and IGT revenues will be fully exposed to the negative impacts of the DN proposals

7. In agreeing migration dates for the legacy portfolio, neither IGTs nor Ofgem foresaw that DNs would propose to rebalance their tariffs. The effect of the DNs' proposals is to push out the horizons at which the "revenue neutral" positions are achieved. Such changes alter the basis upon which the licence change was agreed.

8. In many cases, implementing DN proposals will result in gas shippers seeing transportation charges on IGT networks that are higher than those that would be levied by the incumbent DN. This is because, although the IGT charges will be at the the floor of the cap and collar arrangements, these proposals will result in the CSEP charge to the shipper being higher.

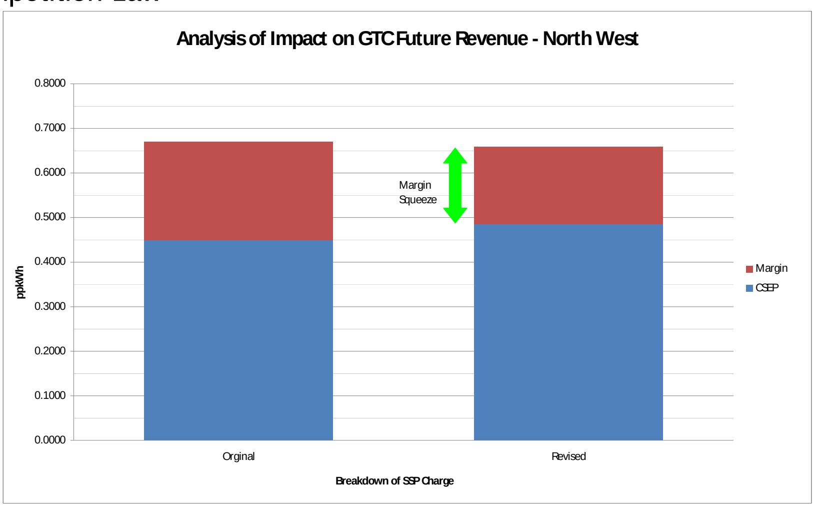
9. Currently domestic customers on IGT networks face additional charges from 4 of the "big 6" gas suppliers of approximately £40 p.a. They attribute this to higher transportation charges in respect of IGT legacy networks.

Impacts to GTC current RPC portfolio

10. Similar to the impact on GTC's "legacy portfolio" implementing the DNs' proposals will result in GTC receiving lower revenues in respect of its existing RPC portfolio, but on the other hand shippers facing higher transportation charges.

Impacts on GTC future revenues

11. GTC have undertaken initial analysis as to the potential impact on GTC revenues as a result of this proposal – an example is shown below. GTC have significant concerns that this constitutes a "margin squeeze" in direct contravention of Competition Law



Annex 2

Questions raised in consultation

Aside from GTC's fundamental concerns with this proposal as outlined above, we have also sought to address the set of specific questions raised within the consultation.

Should we rebalance on a network specific basis or on a national average basis?

In terms of the methodology relevant objectives, namely to provide cost reflective charges, it would appear that this would be better achieved by rebalancing on a network specific basis.

How should we reset charges to maintain the chosen revenue recovery split?

GTC would support a 5 yearly review to perhaps coincide with the GDPCR process. This would appear to provide a level of certainty/stability to charge levels desirable across the industry.
It may also seem sensible to introduce a tolerance threshold in order that onerous minor changes were not necessary.

Is there any reason why these charges should not be rebalanced on 1 April 2009?

GTC strongly believe there are reasons that this should **not** be implemented on 1 April 2009.

1. **Lack of IGT Impact Assessment**

   GTC feel that the potentially significant impacts to IGTs have not been appropriately considered.

2. **Length of consultation**

   IGTs were only made aware of this consultation on 7th October 2008 with a response deadline of 4th November 2008. GTC believe that this does not allow sufficient time in which to carry out a detailed impact assessment to IGT revenues which is necessary to sufficiently inform DNs and Ofgem of the implications.

3. **Objectives of Charging Methodology**

   Within the consultation (Section 5), "*DN's expect to have undertaken separate reviews of the structure of the LDZ System and Customer Charges in time to implement changes in April 2010. An alternative might be to delay* *implementation of the LDZ System/Customer Charge until these reviews are concluded."*

GTC believe that in order for the DNs to sufficiently comply with all objectives of the charging methodology – specifically the requirement to take account of developments within the transportation business - then this must be delayed and dealt with concurrently.