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Dear Sirs

Response to Distribution Networks Pricing Consultation Paper DNPC05 "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 21 October 2009.

These proposals are similar to those presented last year as part of DNPC04 and we acknowledge that, whilst some of the issues from last year have been addressed, others remain.

Given that the proposals continue to have a significant impact on IGTs, we are disappointed;

- at the short period allowed by the consultation for responses;
- at the lack of engagement with IGTs on the proposals ahead of the short consultation period, particularly in light of the concerns raised by IGT's on last year's withdrawn proposal (and given that, collectively, IGTs have circa 1 million end users connected to our distribution systems).
- that a full and detailed impact assessment on the effects that the changes would have on IGTs and Shippers with supply points connected to CSEPs appears not to have been undertaken;

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

- The proposals are based on only 2 year's costs (2007/8 and 2008/9). 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. The 2 years that have been used as a basis demonstrate a marked fluctuation in costs and this demonstrates the point that using short period data of less than 5 years produces unreliable results compared to the actual long term costs.
- 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 not sufficient analysis as to whether the proposals will lead to a margin squeeze on IGT's.
- Shippers will face higher transportation costs if DNOs implement their proposals. This is because, whist the IGT margins remain unchanged under the RPC and Legacy 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 might lead to some IGTs seeking to demonstrate that migration dates for legacy connections need to be adjusted back even further than the current range of 2011 to 2020. We suspect that Ofgem would not welcome this unintended consequence.
- The DNs have incorrectly assumed in the consultation (Part 6) that "a change to the DN charges taking effect from 1 April 2010 will not impact on IGT charges until 1 January 2011" – the impacts will be immediate to CSEP Shippers through increased CSEP costs which make up the IGT costs to a Shipper.

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.

It should also be borne in mind that this attempt to reduce RPC incomes for IGT's comes at a time when IGT charges for RPC sites are in the majority of cases considerably less than the same charge levied where the GDN owns the last mile network because of the operation of the cap and collar arrangements on RPC charges. Whilst GDN's have enjoyed large increases in charges over recent years, RPC charges have not kept up with GDN tariffs because of the price ceiling. We do not believe that this benefit to end customers from the RPC price cap is currently well understood, nor do we believe that shippers or suppliers are passing it on to end customers.

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
Customer 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 revenues of circa 11.5% 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 increased CSEP charges for IGT legacy portfolios.

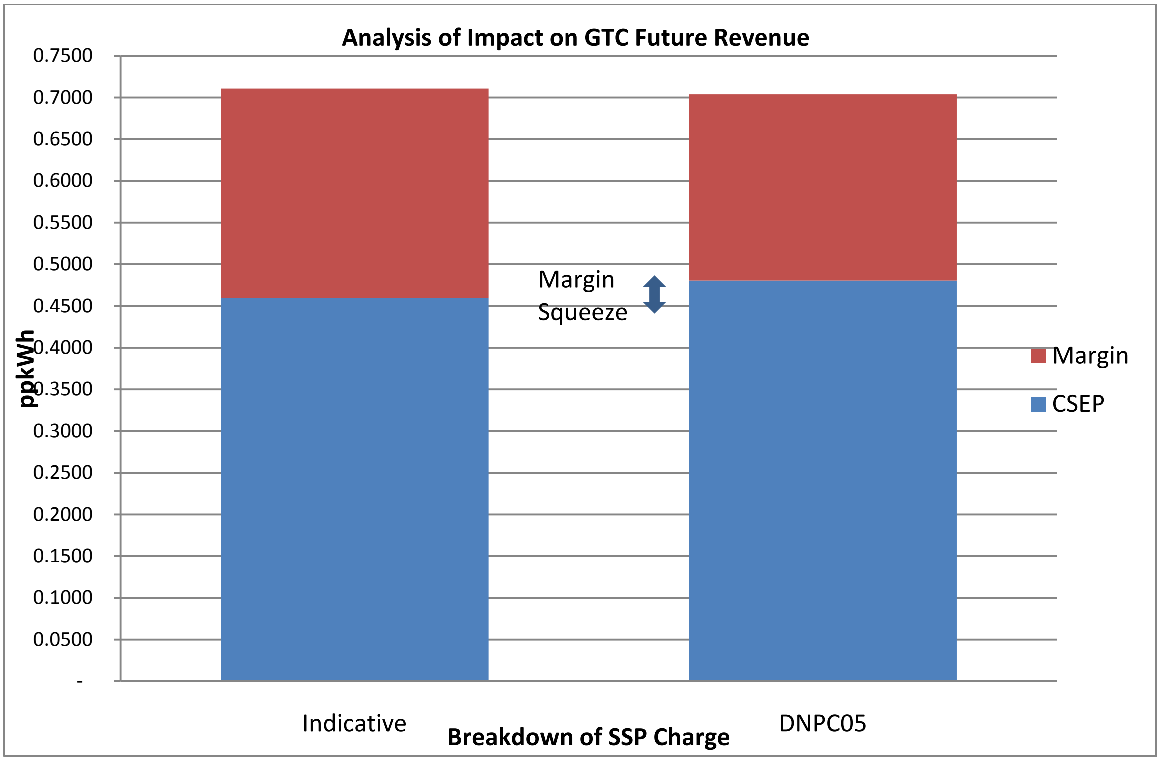
9. Currently domestic customers on IGT networks face additional charges from 4 of the "big 6" gas suppliers of approximately £40 p.a. They attribute this to higher transportation charges in respect of IGT legacy networks.

Impacts to GTC current RPC portfolio

10. Whilst it is true that, due to the operation of the RPC cap and collar, GTC revenues are not significantly impacted by these proposals on average, the principle of reduced revenues remains and GTC could well be impacted in the future. The ability of GTC to provide transportation charges to Shippers well below that of the incumbent in many cases is also significantly impacted by these proposals.

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.

1. Should the methodology for determining that balance of revenue recovery between LDZ System Charges and Customer Charges be changed from the current national basis to a DN specific estimate of the split of the relevant costs?

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.

2. ***Should the balance of costs relating to LDZ System and Customer charges be assessed using an average of an appropriate number of years for which data on a consistent basis is available for each network? An alternative would be to use the cost analysis for just the latest year available?***

   GTC believe that the balance of costs should be assessed using an average of an appropriate number of years. 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.

3. ***Should the balance of charges relating to LDZ System and Customer charges be reviewed at the beginning of each Price Control period, except in exceptional circumstances?***

   GTC believe that the balance of charges should be reviewed at the beginning of each Price Control period subject to a tolerance threshold in order that onerous minor changes were not necessary

4. ***Is there any reason why the proposal should not be implemented from 1 April 2010?***

   GTC strongly believe there are reasons that this should **not** be implemented on 1 April 2010.