26/09/03

Mr Kyran Hanks
Director, Gas Trading Arrangements
OfGEM
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Dear Kyran

Re: Potential sale of Distribution Networks

Thank you for the opportunity to comment on the above consultation.

I would like to begin by saying that I do not have any fundamental objection to the change of ownership of a Distribution Network (DN). If, in Transco's words, it will lead to *"increased opportunity for efficiency through comparative competition"* whom am I to argue. Indeed if the current owner believes that a new owner can introduce improvements that they can then copy the change should be welcomed.

I do however have concerns of a practical nature over the potential negative impact on consumers that a sale could introduce. These concerns centre on the quality of service, the possible high initial implementation cost of system changes and the impact on gas prices that disruption can bring.

On the question of quality of service the recent experience in the electricity industry, where large amounts of compensation have had to be paid, must make us cautious. We must ensure that savings are not achieved at the expense of service to consumers.

With regard to implementation costs I would suggest that these should be borne by the DN owners within the price control and not passed on to the consumer.

the voice of utility users

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On the issues of system changes we must also learn from the experience of the introduction of entry capacity auctions, which took some years to settle down and had considerable impact on gas prices during the early years.

I welcome the fact that OfGEM will be re-examining the Regulatory Impact Analysis as I am unclear as to what benefits will accrue. We are currently seeing under the existing price control, a 2% annual saving on all of Transco's costs. Will this continue after 2007? Earlier this year at the launch of the OfGEM 3-year plan a figure of over £300 million was suggested as the benefit of separate LDZ price controls. Is the £150 - £330 million shown in the RIA additional to both these savings? I would also appreciate an understanding of the phasing of costs and savings as it would appear than costs will fall on existing consumers while savings will benefit future generations.

Moving on to the specific questions asked in the consultation.

<u>Section 4.</u>

As we are unaware at this stage of the number of DNs which will be sold it would appear to be sensible to set a structure assuming that all will eventually be in separate ownership.

This would suggest full structural separation and separate transmission and distribution licences.

With regard to network code arrangements I am totally opposed to separate network codes. We have seen that the development of IGT network codes has proved a barrier to competition and I would welcome the development of a universal network code that included the IGTs.

I believe that the UNC could incorporate transmission and distribution obligations rather than development of separate codes.

I do not feel qualified to comment on the detail of an offtake agreement but would observe that it will require the setting up of yet another panel to oversee modifications to its format.

<u>Section 5.</u>

The question of exit arrangements and interruption is extremely important to consumers who have made long term investment decisions on the basis of a stable and predictable transmission system. The selling of a DN must not adversely affect consumers who happen to be located in a DN that is sold.

The majority of interruptible sites negotiate their contract with a supplier based on the published Transco arrangements. Therefore we would welcome the development of a Universal Interruptible Agreement (UIA) to cover all DNs. This agreement could address the anomaly of allowing a new consumer to request interruptible transportation when firm capacity is available but also recognise the stranded assets of a consumer whose interruption is no longer required due to changes on the network (new investment or closure of another offtake). It could also address the issue of differences in the frequency and extent of interruptions.

On the question of Transco and the DN owner contracting directly with the consumer I believe that those who wish should have the freedom to do so. However I think it unlikely that many DN connected sites will choose this option.

I believe that interruption arrangements should be a combination of market based and administrative covered by a UIA.

Section 6.

I am strongly of the opinion that we should maintain a single balancing arrangement. There are clearly weaknesses in the current arrangements which have been exposed during recent months, however I believe that this would be exacerbated by multiple balancing arrangements. Indeed a system which allows a shipper to sell locational gas to Transco at an inflated price then move to an imbalance position by reducing their daily nomination but overall making a financial gain must be questioned. Perhaps the ability for within day nomination should be re-examined which may also address the issue of profiling.

My views on line pack are well known through my contribution to mod group 513, however I will briefly restate them for the record. I am firmly of the view that linepack is a consumer's guarantee of security of supply and should not be subject to the vagaries of commercial pressures. I believe that a DN owner should be concerned only with transporting gas and ensuring security of supply. They should not be concerned about the cost of the commodity they are transporting nor looking for a commercial opportunity to exploit.

Section 7.

The Supply Point Administration process is of critical importance to consumers. The aim must be that whatever arrangements are introduced should be invisible to consumers and that the transfer timetable should be reduced to the absolute minimum. It is clear that the existing Transco system has been a barrier to the latter of these aims. If a neutral owner of an agency is to be considered the lessons from the electricity industry must be learnt where, in the early days, considerable problems in data gathering and distribution were experienced. It was not uncommon for a site's half-hour data to contain more "cut and paste" figures than actual readings. As an aside it is interesting that in the electricity industry a site spending £12,000 per annum has to have half-hour meters while in the gas industry the break point for daily meters is over £500,000 for a firm site. Perhaps this should be reviewed to help facilitate customer transfers.

On the question of a supplier's role in the SPA process it is clear from a consumers perspective that the supplier is critical to facilitating the change. Therefore it may be appropriate to re-open the 1998 consultation of the role of shippers in the gas industry.

On the question of funding for an agency and the cost of developing any new system we believe that this should be covered by the price control mechanism and not be passed on to consumers.

<u>Section 8.</u>

With regard to gas shrinkage it would appear to be wrong for Transco to retain responsibility for a network which it did not own, therefore shrinkage arrangements would need to be unbundled at this stage.

In general the responsibility for the quality of gas transported should be Transco's. However I can foresee issues such as moisture content which would need to be addressed.

Network planning is of importance to consumers who have been critical of Transco's investment decisions in the past. We would wish to see a planning system that ensures that the whole transmission and distribution system is co-ordinated and planned to provide the capacity in a timely manner.

<u>Section 9.</u>

On the question of the mains replacement cap it is clear that a change of ownership must not allow safety to be jeopardised. However if the cap is to be relaxed where extra work has been identified is it to be tightened where less work is required?

Turning to Distribution charging, I&C consumers have for some considerable time been critical of the current methodology, particularly with regard to the capacity/commodity split. We would however be wary of the divergence of pricing methodologies, as our experience with IGTs has been extremely negative.

Finally I would like to welcome the suggestion of the setting up of a Steering group which should allow the views of stakeholders to be heard when developing the proposals.

This letter is not confidential, as I am happy for my views to be known.

Yours truly,

Eddie

Eddie Proffitt
Gas Group Chairman