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By email only

ES PIPELINES

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DNPC08 – Review of Standard LDZ System Charges

Dear Sirs

On behalf of ES Pipelines Ltd, ESP Pipelines Ltd, ESP Networks Ltd and ESP Connections Ltd ('ESP') may I thank you for the opportunity to respond to the above consultation. ESP is an independent Gas Transporter with a portfolio of domestic and non-domestic connections of all sizes, a large number of which are priced under an RPC charging methodology.

I have set out a number of comments below and hope that you will find them useful.

***Question 1*. Should [GDNs] move to a charging structure which reflects individual network costs?**

ESP's assumption is that current charges were designed to reflect individual network costs, and that this proposal looks to increase this cost reflectivity by allowing the charging function to differ for each GDN. This seems like a reasonable proposal although as with any such change, it is necessary to consider carefully the potential impact that permitting further variance between GDNs may have on competition in connections in different geographical areas, both during and between price control periods. ESP is encouraged by the long notice period for the proposed changes and on the assumption that such changes are not intended to be brought about year on year, the impact on price volatility should be minimised.

ESP would be able to accommodate a varying power factor for each network without carrying out system changes, provided that the structure of the charging formula remains consistent across the board.

***Question 2*. [Does ESP] agree that, based on the analysis shown, transportation charges to CSEPs and to directly connected loads should use the same charging functions?**

ESP agrees that the analysis presented seems to suggest that there is no longer a requirement to distinguish in charging between CSEP loads and directly connected loads. We understand the GDNs' obligation towards cost reflectivity across their charging methodologies, but would comment that a more in depth discussion of the reasons for the existence of the CSEP charge in the first place would have been useful to allow parties to assess both the high level principles and the actual numerical analysis at once.

ESP would however like to highlight one impact of the proposal that has not been identified in the consultation paper. For existing domestic RPC properties, the proposals under consultation have no impact on iGT margin. The impact for future domestic connections is minimal, and again in this regard the proposed implementation timescale is helpful. However, for larger supply points, the proposal gives rise to the potential for <u>significant reductions</u> in iGT revenues.

Under the RPC guidelines, iGTs may charge transportation to larger supply points in one of two ways. This decision is taken up front and must be consistent for all such supply points held by the licensee. Option 1 allows charging in the same way as for domestic properties, i.e. the charges are set at the start based on an agreed supply point AQ, and 'locked down' (subject to an annual changes in line with average GDN price changes and inflation); Option 2 involves a continual tracking of the GDN tariff using present-day charges each time a transportation invoice is raised (in other words, no 'lock down' and charges which always reflect prevailing charges and current AQ). ESP invoices shippers to larger supply points on the basis of Option 2, so methodology changes beyond straightforward tweaks to unit charges can have a significant effect on transportation income.

Across ESP's existing portfolio of larger supply points, the proposed changes bring about the following (based on the 'Parameter Update' option – the 'Best Fit' option has roughly the same effect and for the 'Common Form' option the effect is greater):

- An overall reduction in <u>total</u> transportation charge paid by the shipper of 29%.
- An overall reduction in ESP's transportation revenue of 40%
- An overall reduction in ESP's share of total transportation revenue from 28% to 25%

The proposed changes are clearly beneficial to customers at larger supply points (in the case that their contracts are sufficiently flexible for a reduction in transportation charges to be passed on to them by the shipper). These changes do impact greatly on ESP's income at larger supply points charged under RPC Option 2, and there will not be a commensurate increase in revenues across its domestic portfolio.

Whilst ESP does not question the intentions of the current proposal, we feel that this unintended consequence must not be overlooked, owing to the considerable impact for ESP on the rate of return now permitted on these past investments. We feel that there is merit in highlighting this as a potential item for further consideration if any review of the RPC mechanism as a whole were to be undertaken.

***Question 3*. Which of the three options set out (Parameter Update, Best Fit or Common Option) would [ESP] prefer to be implemented and why?**

ESP's preference for is the Parameter Update option. This is because:

- No system changes would be required on ESP's systems, whereas both other options would require change, either to introduce revised charging bands, or to alter charging functions from power to log
- The structure of the charging functions remains consistent across GDNs. At a time when electricity distributors have only recently implemented a common structure of charges, it would be counter-intuitive for GDNs to diverge, leading to potential for increased variability and more difficulty in understanding methodologies.
- This is the 'least change' option whilst providing the acknowledged move towards cost-reflectivity

***Question 4*. Is there any reason why the proposals should not be implemented from 1st April 2012?**

ESP supports the implementation date proposed.

Please do not hesitate in contacting me should you wish to discuss these comments further.

Yours faithfully

David Speake

ES Pipelines Ltd