Representation

Draft Modification Report

0418 and 0418A - Review of LDZ Customer Charges

Consultation close out date: 02 August 2013

Respond to: enquiries@gasgovernance.co.uk

Organisation: National Grid Gas Distribution

Representative: Steve Armstrong

Date of Representation: 26 July 2013

Do you support or oppose implementation?

0418 - Support

0418A - Not in Support

If either 0418 or 0418A were to be implemented, which would be your preference?

Prefer 0418

Please summarise (in one paragraph) the key reason(s) for your support/opposition.

We consider that 0418 would result in charges which better reflect the transportation costs than the current Customer charge functions do. 0418 would result in the DLCA costs which, being an allowance, and which therefore cannot be reflected in a cost-reflective manner, being reflected across all customers' charges in a way that would not create significant negative impacts for any group of customers, so facilitating effective competition between gas shippers and gas suppliers. By contrast, 0418A would result in the DLCA costs being reflected in a manner that would create extremely large negative charge impacts for many customers. This would be disruptive to effective competition without any clear justification for such a significant rebalancing of charges.

Are there any new or additional issues that you believe should be recorded in the Modification Report?

No

Relevant Objectives:

How would implementation of each modification impact the relevant objectives?

<u>Relevant Objective: That the charging methodology results in charges which reflect the costs incurred</u>

We consider that either modification will better facilitate this objective. There are three categories of cost which are reflected in the Customer charges:

- Emergency Costs;
- Service Replacement Costs;
- Asset Related Costs.

The evidence available on how the first two categories of costs vary with supply point size has been considered. For both modifications we consider that the proposed charging methodology would result in charges which better reflect the costs incurred for these two categories than the existing charges do. In addition the proposed methodology under either modification would better reflect the level of these costs in each distribution network since it explicitly links to the level of the costs in these categories, which the existing methodology does not.

The third category of costs, asset-related costs, is largely related to the cost of the Domestic Load Connection Allowance (DLCA). Since this is a statutory allowance there is no clear way to achieve cost-reflectivity.

Relevant Objective: That the charging methodology takes account of developments in the transportation business

We consider that both modifications would better facilitate this objective because they would link the methodology to the level of costs in each distribution network whereas the existing charges are based on analysis of costs at a national level prior to network sales.

Relevant Objective: That the charging methodology facilitates effective competition between gas shippers and between gas suppliers

We consider that 0418 facilitates this objective whereas 0418A has a negative impact on facilitating this objective. This difference is due to the different means of reflecting the asset-related, largely DLCA, costs in the two modifications and the very different impacts that these create.

Under 0418 the asset-related costs would be reflected in a single flat rate charge element for each supply point. This would effectively apportion these costs across all customers which is consistent with the intent of the DLCA not to charge the particular connection customer for these costs. It is estimated that 98% of these costs would be effectively recovered from domestic customers; however this is still totally consistent with the intent of the DLCA not to charge the particular connection customer for these costs.

Since there is not a clear cost-reflective way to apportion the asset-related costs, apportioning them in a similar manner (on a supply point basis) to the other costs for which there is a cost driver gives a consistent treatment. This is similar to overhead costs, where there is not a clear cost driver, being allocated in the same manner as direct costs are.

Reflecting the asset related costs in this manner under 0418 results in charges which have very small negative charge impacts on domestic supply points (at most a 1.9% increase in distribution transportation charges) and beneficial charge impacts for other types of supply points. We consider that this low level of impact under 0418 will help maintain stable and predictable transportation charges which will facilitate effective competition between gas suppliers and between gas shippers.

Under 0418A the asset-related costs would be reflected in a single rate commodity charge for all supply points. This would effectively apportion the costs across all customers, which is consistent with the intent of the DLCA not to charge the particular connection customer for these costs. We consider that both the 0418 and 0418A apportionment methods for the DLCA costs equally preserve the intent of the DLCA in this respect. However, the introduction of a commodity charge for this purpose under 0418A would result in extremely large negative impacts for many sizes of customers with some customers (those with very large loads) seeing increases of over 100% in their distribution transportation charges and most industrial customers seeing distribution charge increases of over 20%. We consider that negative charge impacts of this significance would be highly disruptive to the market and so would have a significant negative impact on facilitating the securing of effective competition. Indeed, we think that the negative impacts in this respect are so significant that they outweigh any benefits the improved cost reflectivity of other aspects of 0418A might provide.

Given that 0418 provides the same cost reflectivity benefits as 0418A and uses a cost apportionment methodology for the asset-related costs equally in line with the DLCA intent but without the significant negative impacts of 0418A, we can see no merit in 0418A compared to 0418 and consider that 0418A has very significant disadvantages in terms of its impact on the relevant objectives.

Impacts and Costs:

What analysis, development and ongoing costs would you face if either modification were implemented?

Xoserve system costs are anticipated for implementation of either modification. No additional ongoing costs are envisaged.

Implementation:

What lead-time would you wish to see prior to either modification being implemented, and why?

We consider that either modification should be implemented on 1 April only of any year unless the economic and efficient implementation of the Nexus changes suggests an alternative date may be appropriate. We consider that 0418 should not be implemented prior to 1 April 2015 to enable time for Xoserve invoicing system changes and an appropriate notification timescale. Later implementation of 0418A might be appropriate so as to provide a longer notification timescale given the extremely high level of charge impact that this modification would create.

Legal Text:

Are you satisfied that the legal text will deliver the intent of each modification?

Yes

Is there anything further you wish to be taken into account?

Please provide any additional comments, supporting analysis, or other information that that you believe should be taken into account or you wish to emphasise.

No