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*Promoting choice and  
value for all customers*

Dear Colleague,

**Transmission Price Control Review 4 – Assessment of the process -  
243/07**

Our principal duty is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition. Transmission Operators (TOs) transmit wholesale electricity and gas through networks of wires and pipes. TOs retain an effective monopoly in the core services that they provide to consumers, because it is not possible or appropriate to introduce competition. We seek to protect the interests of consumers through a variety of regulatory tools, such as price controls and standards of performance.

The current Transmission Price Control Review (TPCR), which relates to the period 1 April 2007 – 31 March 2012, has resulted in total revenue allowances for TOs of around £1.7 billion per year over the five year period, including capital investment allowances of some £4.6 billion. These revenues are recouped from network users from use of system and connection charges. Given the magnitude of the monetary sums involved, it is essential that the process for establishing the allowed revenues of TOs is robust and consistent with our principal duty.

The TPCR had regard to recommendations on process that were made following the Electricity Distribution Price Control Review (2005-2010)<sup>1</sup>. The purpose of this letter is to elicit responses from interested parties on how we conducted the TPCR, with a view to understanding what elements of the review were perceived to have been conducted well, what could be improved and, what should be done differently in future reviews.

Please note that it is not the intention of this assessment to identify whether the policies in the Final Proposals were appropriate. The focus of this assessment is on the processes followed in conducting the review.

**Overview of the TPCR process**

The first formal consultation document on the TPCR was issued in July 2005. Final Proposals were issued in December 2006. In all, we issued six main documents during this 18 month period, along with many appendices to these documents. A statutory consultation on the licence modifications necessary to bring effect to the Final Proposals was issued in March 2007 for the electricity and June 2007 for gas. A timeline of the main documents is attached as an appendix.

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<sup>1</sup>

[http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/11955\\_17505.pdf?wtfrom=/ofgem/whats-new/archive.jsp](http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/11955_17505.pdf?wtfrom=/ofgem/whats-new/archive.jsp)

In our initial consultation in July 2005, we set out the main objectives as to:

- protect the interests of consumers,
- promote social and environmental objectives,
- reward focused and timely investment, and
- allocate risk appropriately

Additionally, we set out that we would seek to ensure that our actions were consistent with objectives of transparency, inclusiveness, and accessibility

In July 2005, we explained the scope of the review as being to:

- set new price controls to take effect from 1 April 2007 for the gas transmission licensee (NGG NTS) and the three electricity transmission licensees (SHETL, SPTL and NGET), and
- determine revenues for both the electricity and gas system operators' incentives to take effect from 1 April 2007.

We also identified a number of workstreams that were related to the TPCR but outside its scope, which included:

- reliability incentives for transmission licenses,
- setting unit cost allowances for new gas transmission system entry points,
- transitional gas transmission offtake arrangements, and
- review of NGET's transmission charging methodology to fulfil certain conditions set by the Authority as part of its approval for the methodology in March 2005

## **TPCR activities**

### *TPCR meetings*

We had numerous meetings with the TOs in all workstreams throughout the process. We also held a public workshop after our Initial Proposals in June 2006 in order to elicit as wide an input as possible.

On the day of publication of each of the Proposals papers (in June, September and December 2006), we conducted conference call presentations for financial analysts.

Throughout the process, our staff met with interest groups to consider their representations. In addition, a committee comprised of Gas and Electricity Markets Authority members held bilateral meetings with senior management teams from each of the TOs on three separate occasions.

### *Capex and opex cost assessment*

We issued a historic business plan questionnaire information request in July and August 2005, followed by a forecast business plan questionnaire in October 2005. In both cases, drafts of the questionnaires were subject to extensive consultation and discussion with the TOs. Our staff and consultants visited the TOs to gain further insights and clarification of their business cost structures for both the opex and capex assessments throughout the TPCR.

### *Financial issues*

Some of the key financial issues (e.g. pensions, cost of capital and the release of the financial model) could only be determined late in the process due to the nature of the information involved and their reliance on other related issues. However, TOs were kept informed of our position on key issues throughout the TPCR. In the case of pensions we applied the same the principles for determining allowances that were established during the electricity distribution price control review.

### *Licence modifications*

We began consultation on the proposed licence modifications November 2006 when we published informal consultations on drafting for gas and electricity licences. The consultation on proposed modifications for the electricity under section 11 of the Electricity Act 1989 was published in March 2007 and took effect from 1 April. Further informal consultations for the modifications to the NTS gas transporter licence were published in January 2007 and April 2007, and the consultation under Section 23 of the Gas Act 1986 was published in June 2007. The decision modifying the NTS gas transporter licence was published in September 2007 having retrospective effect from 1 April 2007.

### **Process issues for consideration**

This section lists a number of issues that need to be considered for assessing the processes used during the TPCR. These can be considered against the overall control, but also against the individual workstreams as appropriate. We have highlighted those key issues against which the processes should be assessed to elicit responses from interested parties. However, there may be other issues that respondents may wish to raise. In order to maximise the benefit for all parties, it would be best if respondents could be as specific as possible when quoting examples on any of these issues.

### *General principles and objectives*

With regard to better regulation principles, we would welcome views on whether:

- the objectives of the review (as set out above) were appropriate;
- our processes facilitated the effective delivery of these objectives (or if not, why not); and
- the manner in which we attempted to achieve these objectives conformed to the principles of better regulation.

### *Communication*

How effective were the channels and methods of communication? Was it possible to make more use of electronic communication compared to face to face meetings? Were the appropriate individuals with responsibility for work areas within Ofgem clearly identified to interested parties? Were we open and receptive to comment and criticism during the TPCR? Did stakeholders have access to the appropriate levels of seniority within Ofgem to resolve issues as they arose?

### *Meetings and workshops*

We held a number of meetings and workshops during the process. Did participants find these useful? Were the right people invited? Were there too many/too few meetings? Were meetings focused on the right issues? Were they held at appropriate stages of the process? Was there sufficient co-ordination between meetings and workstreams? Subject to confidentiality were the discussions in meetings sufficiently transparent and minutes timely produced?

### *Preparatory work*

Was the planning work useful? Did it target the areas of greatest importance for the TPCR? Was there anything else which could have been done at the planning stage?

### *Use of consultants*

Were consultants used in an appropriate manner by us throughout the TPCR? Were consultants employed at the right time during the TPCR? Was the output from our consultants perceived to be fair and unbiased? Should we be doing more or less of the work in-house?

### *Consultation process*

Was the overall consultation process too lengthy, about right or too short? Did we produce the right amount and level of information so that all interested parties could understand the TPCR? Were there too many/too few consultation documents? Were all relevant issues consulted on? Were the response periods for these documents sufficient? Was there any conflict in time with any other consultations? Was there evidence that respondents' views were considered? Did our documents give a fair and balanced account when respondents had contrary or conflicting views?

### *Requests for, and use of, information*

Were our requests for information appropriate and proportionate? Was the consultation on draft information requests useful? Were consultants sufficiently integrated in the drafting of information requests? Did we give appropriate explanation and justification for all information requests? Did regulated companies have sufficient time to meet our information requests? Was all the information requested used in the TPCR? Was it possible to avoid some of the information requested / further requested?

### *Timeline*

Were the timelines for the various work streams appropriate? Was it appropriate to schedule the Final Proposals for December 2006? Was it appropriate to issue an update in September 2006, in between the Initial and Final Proposals? Which issues were addressed to soon/too late in the process?

### *Regulatory consistency*

Was the content of our Final Proposals document consistent with the views it expressed throughout the TPCR? Were there inconsistencies between the previous TPCR and the manner in which analysis was conducted during this TPCR?

### *Transparency*

Were the processes and analyses conducted by us and our consultants sufficiently transparent? Was the underlying data provided by TOs sufficiently transparent?

### *Access to Ofgem & the Authority*

During the TPCR, both Ofgem and Authority members met with various interested parties (environmental groups, consumer and union representatives, financial analysts and DNOs). Did groups encounter reluctance on our part to arrange meetings? Was Ofgem properly represented at such meetings? Were Authority members willing to engage at appropriate stages of the process? Were these meetings productive?

### *Further work*

There are ongoing work streams that have arisen as a result of the TPCR, e.g. regulatory reporting, development of output measures, gas network planning and modelling, Scottish Island connections. Are the links between these work streams and the TPCR clearly defined? Are such work streams an appropriate means of dealing with the outstanding issues?

### *Process delivery*

Overall did the process work? Did it effectively deliver a price control in a cost efficient and timely manner? What is an appropriate timescale for conducting such a price control review? Did we deploy sufficient resource, too much or too little and at the right time in the process? Were our teams comprised of the correct range of competencies to deliver an effective price control?

### *Positive points*

What parts of the process worked well? Which elements added the most value to the process? What aspects should be retained for future reviews?

### *Potential improvements*

Were there any flaws in the process? How could the overall process be improved? What were the biggest problems? What change should be made to the process to avoid a repetition of these problems?

### *Other issues*

What issues have been omitted from the points highlighted above? Are there any other observations that should be made regarding the TPCR? Are there other issues we should be addressing in 2008 and 2009 as early preparation for TPCR5?

## **Responding to this letter**

We would like to hear the views of all those with an interest in the development of price controls, including consumers and their representatives, investors and city analysts, environmental groups, generators, suppliers and regulated entities.

Responses to this letter are due by **9 November 2007** and should be sent to:

Michael Knowles, Ofgem, 9 Millbank, London SW1P 3GE  
E-mail: [michael.knowles@ofgem.gov.uk](mailto:michael.knowles@ofgem.gov.uk) Tel : 020 7901 7118

Where possible we would prefer responses to be sent electronically. Unless marked as confidential, all responses will be published by placing them on the Ofgem website. Any questions on this letter should be directed to Michael Knowles in the first instance.

**Next steps**

Following responses to this letter we intend to hold a special meeting with the licensed TOs. We are also keen to know whether there is any interest from others to hold a public meeting on these issues. Following responses we will decide on whether there is sufficient interest to hold such a public meeting.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Robert Hull', with a horizontal line underneath.

**Robert Hull**  
**Director - Transmission**

## Appendix - Timeline of the TPCR

July 2005	<ul style="list-style-type: none"> <li>Initial Consultation (Ref No. 172/05)</li> </ul>
December 2005	<ul style="list-style-type: none"> <li>Second Consultation (Ref No. 277/05)</li> </ul>
February 2006	<ul style="list-style-type: none"> <li>Capital Expenditure Projections 2007-2012 (open letter) (Ref No. 21/06)</li> </ul>
March 2006	<ul style="list-style-type: none"> <li>Third Consultation (Ref No. 51/06).</li> <li>Third Consultation, Appendices (Ref No. 51/06b)</li> </ul>
May 2006	<ul style="list-style-type: none"> <li>Access Reform in Electricity Transmission: Working group report and next steps (Ref No. 83/06a).</li> <li>A framework for considering reforms to how generators gain access to the GB electricity transmission system: A report by the Access Reform Options Development Group (Ref No. 83/06b).</li> </ul>
June 2006	<ul style="list-style-type: none"> <li>Initial Proposals (Ref No. 104/06).</li> <li>Initial Proposals, Main Appendices (Ref No. 104b/06).</li> <li>Initial Proposals, Appendix: Offtake Revenue Drivers and Baselines for NGG NTS (Ref No. 104c/06).</li> <li>Initial Proposals, Draft Enduring Offtake Impact Assessment (Ref No. 104d/06).</li> </ul>
September 2006	<ul style="list-style-type: none"> <li>Updated Proposals (Ref No. 170/06)</li> <li>Updated Proposals, Appendices (Ref No. 170/06a)</li> </ul>
November 2006	<ul style="list-style-type: none"> <li>Draft licence modifications (gas and electricity) (Ref No. 197/06)</li> </ul>
December 2006	<ul style="list-style-type: none"> <li>Final Proposals (Ref No. 206/06)</li> <li>Final Proposals, Appendices (Ref No. 206/06a)</li> </ul>
January 2007	<ul style="list-style-type: none"> <li>Draft licence conditions 2<sup>nd</sup> informal consultation (electricity) (Ref No. 10/07)</li> <li>Draft licence conditions 2<sup>nd</sup> informal consultation (gas) (Ref No. 16/07)</li> <li>Draft licence conditions 2<sup>nd</sup> informal consultation (gas), appendix (Ref No. 16a/07)</li> </ul>
March 2007	<ul style="list-style-type: none"> <li>Statutory consultation on licence modifications (electricity) (Ref No. 39/07)</li> </ul>
April 2007	<ul style="list-style-type: none"> <li>Draft licence conditions 3<sup>rd</sup> consultation (gas) (Ref No. 95/07)</li> <li>Draft licence conditions 3<sup>rd</sup> consultation (gas) appendices (Ref No. 95a/07)</li> </ul>
May 2007	<ul style="list-style-type: none"> <li>Draft licence conditions 3<sup>rd</sup> consultation (gas) open letter (Ref No. 117/07)</li> <li>Draft licence conditions 3<sup>rd</sup> consultation (gas) open letter (drafting) (Ref No. 117a/07)</li> </ul>
June 2007	<ul style="list-style-type: none"> <li>Statutory consultation on licence modifications (gas) (Ref No. 151/07)</li> </ul>
July 2007	<ul style="list-style-type: none"> <li>Statutory consultation on licence modifications (gas) (Ref No. 195/07)</li> </ul>
September 2007	<ul style="list-style-type: none"> <li>Decision to modify the NTS gas transporter licence.</li> </ul>

Copies of the consultants' reports and responses to our consultation documents can also be found on our website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).