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Open letter consultation on Transmission Price Control Review 5 (TPCR5) July 2010

Dear Hannah,

We welcome the opportunity to comment on the issues raised in this open letter. This response is provided on behalf of the RWE group of companies, including RWE npower, RWE Supply and Trading GmbH and RWE npower renewables, a fully owned subsidiary of RWE Innogy.

We agree that Ofgem has identified the background against which Transmission Price Control Review 5 (TPCR5) will need to be undertaken. It is clear that the energy sector will face significant future challenges in meeting climate change and renewable energy targets and delivering security of supply cost effectively. The electricity and gas transmission networks will both have a key role in facilitating delivery of this sustainable energy sector. The Authority's minded-to decision on the RPI-X@20 recommendations[1], suggests that TPCR5 will be conducted under a new regulatory framework, Sustainable Network Regulation.

The open letter sets out Ofgem's initial views on the key issues for the gas and electricity transmission reviews. At a high level, we agree with the issues identified. There are key aspects of the commercial framework that Ofgem has indicated may need to be reformed to remain consistent with the new regulatory framework. These include gas capacity auctions, gas entry and exit arrangements, electricity transmission access arrangements and system operator incentives. It is appropriate to review these and to ensure that the gas and electricity commercial frameworks are complementary and consistent with wider market developments. For instance, given increased penetration of intermittent generation to meet climate change targets, gas-fired generation will have a key role in providing system security and it would appear counter-intuitive that elements of the gas market arrangements are removing flexibility from the NTS.

[1] Regulating energy networks for the future: RPI-X@20 Recommendations, July 2010

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In order to reflect the uncertainty about what network companies need to do to deliver a future sustainable energy sector, Ofgem is proposing an outputs-led framework. The outputs-led approach will see Ofgem moving away from approving individual projects or assets and agreeing to a set of high-level outputs and secondary deliverables. The package of measures will include uncertainty mechanisms and incentives on the networks to respond to and anticipate future needs and to deliver value for money over the longer term. We have a number of concerns about Ofgem's proposals to use an increasing number of incentives within the regulatory framework and, in particular, the suggestion that incentives should be symmetric in all cases. Our experience with electricity and, to a lesser extent, the gas SO incentives is that there is a lack of transparency and Ofgem need to recognise this when agreeing what appears could be an similarly complex set of incentives under TPCR5.

A particular area of concern for us is in relation to anticipatory investment and the implication that there will be increased government intervention in determining the networks' investment programmes. Our view remains that rather than undertake wholly anticipatory investment, the case for which may be poorly defined, this investment must be guided, at least in part, by user commitment. This will minimise stranding risk as assets will be constructed where users who are willing to commit, require them and ensure that scarce resources are correctly deployed. To the extent that anticipatory investments are permitted, there needs to be an appropriate balance between risk and reward faced by the networks and consumers. This issue needs to be included in the scope of TPCR5.

We have long argued the case for predictable transportation costs. Introduction of incentives around delivery of a range of primary outputs, efficiency incentives and uncertainty mechanisms is likely to introduce more volatility as performance against the "basket" of outcomes will tend to vary year-on-year, as well as between price control periods. In turn, this will make transportation costs much more variable and harder to forecast. Given concerns about the relative opacity around performance against the package of SO Incentives, our strong preference is for improved transparency in this area and that charging updates comparing achievement of actual against allowed revenue, are published at least quarterly.

The letter also outlines Ofgem's proposed approach to stakeholder engagement and overall project management. We welcome stakeholder engagement in the process, but Ofgem must recognise that there is a significant information asymmetry between the network companies and network users. Historically, the network companies have met their customers one on one to discuss the issues and we expect this to continue. Taking specific aspects of the price control review process forward in specially convened fora is a pragmatic way of developing views and options. Given the restricted membership proposed, it will be important that any outputs are shared widely. As set out in Annex D of the open letter, there seems to be less public meetings and consultations than in previous reviews. In our view, these should both be increased.

We hope these views are helpful and if you wish to discuss any aspect of them in further detail, please do not hesitate to contact me.

Yours sincerely,

By email so unsigned

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