

12 February 2003

Regulation

National Grid House
Kirby Corner Road
Coventry CV4 8JY

Telephone No: 024 7642 3943

Fax No: 024 7642 3945

Email: tim.tutton@uk.ngrid.com

Frances Warburton
Head of Gas Distribution Regulation
Regulation and Financial Affairs Division
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Dear Frances

Response to Consultation document – The Regulation of Independent Gas Transporter charging – Draft Proposals

We welcome the opportunity to comment on Ofgem's proposals for the regulation of IGT charging. Since the proposals do not directly impact on Transco, our comments are mostly limited to points of regulatory principle, as set out below.

The Need for IGT Price Controls

A general point of principle to consider is whether it is actually appropriate to regulate IGTs to the extent proposed by Ofgem. On one hand, IGTs have developed in a competitive environment, effectively bidding against Transco and each other to provide new pipeline infrastructure to end consumers. On the other hand, we note the need to protect the interests of customers who are effectively 'locked-in' to an established IGT. However, if Ofgem conclude that IGT price controls are necessary, we believe that it may be more appropriate to use an inter-IGT benchmark as a comparator rather than Transco's charges.

Transco as a comparator

The draft proposals outline a relative price cap for IGTs based on a notional equivalent charge that would be levied by Transco (CSEP to Single Supply Point). Evidence provided in the draft proposals suggests that IGTs may be able to develop a sustainable business with prices at or below those of Transco, thus implying that a relative price control could secure the viability of IGT developments, whilst ensuring that end users are protected from excessive IGT charges.

However, for the following reasons we do not believe that Transco equivalent charges represent an appropriate comparator:

- In accordance with the relevant objectives defined in Amended Standard Condition 4A(5) of our GT Licence, we believe that our transportation charges are reflective of the costs that we incur in our transportation business. However, our charges are influenced by technical and historical elements of our regulatory asset value as determined under our current price control formula. As a consequence, any notional equivalent charges derived from Transco's charges are unlikely to fully align with the actual costs of building and operating a new network.
- Transco's current price control allows 50% of costs associated with the mains replacement programme to be expensed, resulting in higher charges than would otherwise be the case if costs were 100% capitalised.

Both these issues have a fundamental impact on our charges, but are unrelated to the cost of developing an operating IGT network. For this reason, using Transco's charges as a comparator for IGT charges would be inappropriate.

Review of the structure of Transco's charges

Ofgem suggest that it may be appropriate to review the structure of Transco's LDZ system charges to ensure that efficient price signals are being sent to consumers and IGTs. However, given our belief that using Transco's charges as a benchmark for IGT's would be inappropriate, we consider a review of Transco's charging structure to be unnecessary.

Alternative Proposal - IGT benchmarking

As indicated above, our charges are driven by a number of historic issues, such as an old and heavily depreciated asset base and the issues surrounding the derivation of an appropriate regulatory asset value when Transco was spun out of British Gas, and the expensing of mains replacement costs. Our charges are not therefore an appropriate comparator for setting IGT prices. Instead, we believe that a more appropriate benchmark for IGT charges would be the IGTs themselves, applying comparative inter-IGT benchmarking techniques to the data already gathered by Ofgem.

Separate arrangements for rural infills

The draft proposals raise the issue of whether price controls should cover rural infills. We believe that rural infill projects should continue to be dealt with under GT Standard Licence Condition 4C and should not be considered under the proposed form of regulation. It should be recognised that each infill project is different and the flexibility in allowing a supplemental transportation charge to be applied will often provide GTs with the facility to tailor the charge to meet the needs of the individual community.

Any application to apply supplemental transportation charges should be approved by Ofgem on an individual basis, as is the current situation.

Conclusion

We recognise that the current IGT charging regime creates anomalies which raise pricing concerns for some customers on IGT networks. We support the removal of these anomalies and believe this can be done whilst protecting the competitive market that has already emerged. If price controls are deemed necessary to achieve this, we believe that benchmarking IGTs against each other would be more appropriate than deriving a notional Transco equivalent charge.

Yours sincerely

Tim Tutton
UK Director of Regulation