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**By Post and Fax**

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**Developing network price controls: initial consultation  
Comments from Transco plc**

Transco welcomes the opportunity to comment on Ofgem's initial proposals on the work programme needed to develop network price controls. Given its ownership of the gas distribution networks, Transco is concerned to ensure appropriate consistency between the approach taken for gas and electricity networks, and looks forward to taking a direct role in the work programme over the next six months.

This response focuses on some specific issues arising from the recent Transco price control review. Given the proposed merger between Lattice Group plc and National Grid Group plc to form National Grid Transco, expected to be completed in the autumn, future Transco input will be through the combined regulatory team of the new Group. Transco has seen and would wish to be associated with the comments from NGC in Tim Tutton's letter of 17 September.

**Scope of the programme**

The consultation document indicates that the scope of the project includes the TO price controls for Transco's National Transmission System and for the National Grid Company, but does not cover the SO incentive schemes. Transco considers that this distinction is artificial, given that the proposed SO entry and exit capacity investment incentive schemes are the basis for incentivising and financing changes to the investment baseline in the TO control.

To the extent that investment incentives are one of the key issues covered by this programme, it would seem sensible that the handling at future reviews of additional investment taken forward under the provisions of the SO incentive schemes should be explicitly covered in this project. Experience with the Transco price control review suggests that the current split of accountabilities for transmission issues between the Trading and Regulation teams does not always provide for the necessary clarity on objectives and implementation needed in this important area. If for some reason full coverage of transmission investment incentives as part of this project is not possible, then we would suggest that all issues relating to transmission price controls should be excluded from it.

### **Price control objectives**

It is clearly important that the objectives for each review are established and agreed before detailed work commences. If this is not done, the framework for the review, and the detailed business plan projections, will be developed in isolation and may not be consistent with the final objectives.

While the objectives set out in the consultation document are appropriate at a high level, they do not provide the precision needed to ensure that the work programme for the review is focused on key public interest objectives. For example, establishing what quality of service is 'appropriate', or determining at what level security of supply should be 'maintained' are essential early steps in a review. Properly established, such objectives would help to provide a longer term perspective which is important given the long term nature of infrastructure investment in the energy sector.

Putting more time and resource into a statement of regulatory policy would, by focusing subsequent effort, improve the efficiency of the review process itself. As suggested in the recent OXERA/Norton Rose report on appeal mechanisms, it may also provide a basis for greater objective discussion of these issues, and thereby improve the predictability, transparency and consistency of regulation, in line with BRTF principles. Arguably, this would have reduced the extended timescale for implementation of the last Transco price control review; although coming into effect retrospectively from April 2002, the formal licence modifications are yet to be made nearly six months later.

### **Review and monitoring**

Given the significant resources put into a price control review, both by Ofgem and the companies, a full 'post project review' would be appropriate as for any major investment project. Transco is not aware that this is being done systematically by Ofgem, and believes that the current project could usefully have been informed by such a review. Even at this stage, Transco would be willing to work with Ofgem to draw up a list of issues which went well, and which went less well. In the light of this, it would be possible to identify some key lessons to be learned, which – to the extent they cover areas within the ambit of this project – could then be explicitly built into the work programme.

It is generally accepted that the conclusions of a price control review need to be explicit about not only prices, but also outputs and the allocation of risk if delivery is

to effectively monitored. The most recent Transco review has made significant advances in this area compared with the previous review. However, despite the considerable amount of joint effort put into developing a capex monitoring regime for Transco as an input to the last review, it is still unclear how monitoring is to be taken forward in the current review period.

While changes in the regulatory framework as a result of a Periodic Review are inevitable, these too should follow BRTF principles.

Yours sincerely

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