



Ofgem
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For the Attention of Mr David
Gray – Managing Director –
Regulation and Financial Affairs

Dear Mr Gray

Timetables for Price Control Reviews

British Gas Trading (BGT) welcomes the opportunity to provide comments to Ofgem on the above letter that was published on the 17th November 2003.

We recognise that with the level of mergers, sell-offs (actual and potential) and increasing interaction between the gas and electricity markets within Great Britain it is appropriate to review the arrangements that apply to the setting of all Price Controls which cover the affected parties. In principle, we agree with Ofgem that the co-ordination of areas where there are obvious interactions and implications for consistency across both Price Controls and incentives has merit. However, in achieving this, due regard needs to be taken of the following issues:

Workload

The requisite effort and resources required from Ofgem and affected parties (e.g. Shippers and Suppliers) will be significantly increased both in managing the ongoing assessment (due to the increased complexity of the arrangements) and the increased input required during the renewal process through the alignment of the Price Controls. It should be noted that generally, within the industry, the same personnel are responsible for providing the input to Ofgem for the majority of the Price Controls and incentive schemes.

Alignment Process

Both during the process of aligning the gas and electricity Price Controls and going forward on a longer term basis, great care needs to be taken by Ofgem to ensure that no perverse incentives are created within the separate Price Controls. This applies specifically to NGT, which will have a number of Price Controls and incentives schemes applying across numerous businesses. It is essential that neither any one party benefits from windfall gains as a result of the proposed changes, nor that customers suffer any deterioration in service at any point. It may therefore be prudent to adopt mechanisms that allow for ongoing review of the details of terms within a Price Control framework both by the licensee and the affected parties, similar to that embodied in NGC's current SO Incentives Control.

Extension of existing Price Controls

This is perhaps the key area of our concerns. Price Controls by their nature are a complex set of arrangements that have been developed to cover specific issues relating to the Price Controlled

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entity and the environment they will be operating in **during the control period**. As such, it is essential that Ofgem revisits all elements of each control to confirm that they are still appropriate, this should include, but is not limited to, revisiting incentives, the capital expenditure programme and asset base. Great care should be taken that previous problems encountered when Price Controls were simply extended (for example by Offer) are not repeated. It is also appropriate to consider in this regard, with the subdivision of some price-controls, the implications of the allocation of “k-factor” monies at the time of initial separation as any extension could exacerbate any errors.

Ongoing industry change

We agree with Ofgem that careful consideration needs to be taken where a price-controlled business has interactions with ongoing work programmes. This is especially the case for gas distribution networks and their potential impending sale. The proposal to simply split the current total LDZ control between the gas networks was accepted partially on the basis of the remaining life-span of this control. If it is now Ofgem's intention to extend this control, we suggest this will need to be discussed as part of a specific industry consultation to address issues such as the variable mains replacement programmes etc..

We agree with the comments made by Ofgem, that the Price Controls relating to the Scottish transmission networks will need to take account of the implementation costs of BETTA as well as any cost savings arising out of this implementation. We further agree that this work will need to encompass work on setting separate SO and TO components for BETTA. This body of work is being undertaken as part of the BETTA project.

Timing

Whatever decision Ofgem takes in respect of adjusting to the new circumstances, there will need to be some changes and extensions to the current Price Controls. As such, we suggest that timely decisions will need to be made by Ofgem. This is particularly the case when considering the implications for the industry in respect of ongoing industry change as mentioned above.

In conclusion, BGT agrees that it is appropriate for Ofgem to update the existing timetable to enable the gas and electricity Price Controls to be aligned. However, we suggest that great care needs to be taken in any extension of the current controls. We do not accept that a “simple “ roll-forward of the current Price Controls will be acceptable, as it is unlikely to deliver the intended effects and could undermine the intent of the Price Controls. We believe that all elements of each control should be revisited to ensure that the controls continue to be set at an appropriate level. It is also essential that no perverse incentives are inadvertently included in the controls. We would therefore encourage Ofgem to commence this significant piece of work at the earliest opportunity.

Should you wish to discuss any of our comments, please do not hesitate to contact me.

Yours sincerely,

Simon Goldring
Transportation Manager

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