

Sonia Brown
Director, Transportation
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Your ref
Our ref
Name Charles Ruffell
Phone 01793 89 39 83
Fax 01793 89 29 81
E-Mail charles.ruffell@rweinnogy.com

May 17th 2004

ALLOCATION OF ROLES AND RESPONSIBILITIES BETWEEN TRANSMISSION AND DISTRIBUTION NETWORKS
Regulatory Impact Assessment April 2004

RWE Innogy welcomes the opportunity to respond to Ofgem's Regulatory Impact Assessment (RIA) on the allocation of roles and responsibilities between the transmission and distribution networks. These comments incorporate the views of RWE Trading and RWE Innogy's retail business, npower. We are also responding to the Agency and Governance RIA and these should be considered in conjunction with each other.

Introduction

Our comments relate to this RIA rather than the principle of selling a Distribution Network (DN) business. We still remain to be convinced of the level of any benefits to end-users that will be realised. The new DN owners will seek to improve efficiency, innovate and drive down their costs. The introduction of comparative regulation will lead to improved cost efficiency in all DNs, leading to lower gas transportation costs. At this stage it is not clear what scope there is for innovative provision of services in the DN or actual opportunities to reduce costs.

However, any expected benefits will be reduced by the costs associated with a DN sale and the enduring market structure established for the divested industry. These will include costs directly attributable to any sale as well, consequential costs such as the loss of scale economies and ongoing costs. Although we understand that certain costs specifically related to Control Centres will be excluded when setting future price controls, we would appreciate further clarification of how the "efficiently incurred" test will be applied in practice. We believe that it is important for shippers and potential DN owners to understand the magnitude of the costs under consideration here.

RWE Innogy plc

Trigonos
Windmill Hill Business
Park
Whitehill Way
Swindon SN5 6PB

T +44(0)1793/89 27 59
F +44(0)1793/89 29 81
I www.rweinnogy.com

Registered office:
Windmill Hill Business
Park
Whitehill Way
Swindon SN5 6PB

Furthermore, a divested industry structure could lead to excessive fragmentation of industry agreements and processes, creating a situation where it becomes more expensive or contractually more difficult to supply consumers. We recognise that some divergence will be a natural feature and believe that the effects can be managed through effective governance and agency arrangements. These ongoing costs are difficult to assess, but represent a real concern about the consequences of a sale. The Authority has recognised that, under some circumstances, the potential costs could outweigh the expected benefits. In order to protect customers' interests in these circumstances, NGT has agreed in principle to a compensation safety net and we would welcome further clarity about its application.

Regulatory Impact Assessment

We share Ofgem's view that as each DN will be responsible for managing its own network's support services and workforce, many of the efficiency savings associated with a DN sale are likely to arise irrespective of the final allocation of roles and responsibilities.

However, we believe that it remains important to allocate roles and responsibilities in a way that clearly defines obligations, accountabilities and operational responsibility between parties. Network operators should be exposed to the costs associated with a failure to invest in and operate their pipeline systems efficiently. Obligations will be set out in the GT licence and the Safety Case and a clear delineation of roles makes it easier to monitor performance and should reduce the need for complex arrangements for market participants and regulatory authorities. Having defined responsibility for these obligations, we believe that it is for the network operators how they discharge their responsibility.

NGT has proposed the System Operation Management Services Agreement (SOMSA) so that DN owners can meet their system operation responsibilities from day one. At this stage it is not possible to say whether any DN owner will set up their own Control Centre in the future, although the SOMSA is seen as a transitional arrangement. The SOMSA should be designed in such a way that does not prevent DNs from pursuing other options.

This RIA considers how system operation, investment and maintenance activities should be allocated between the NTS and DNs. Ofgem has set out three main options and has determined a number of criteria against which to judge each option. We would make the following observations on each of the options:

Option 1 – Active DN

As the DNs are autonomous, this option maximises the expected benefits from the introduction of comparative regulation between the DNs. It also carries the greatest risk of fragmenting the market. An important consideration is where decisions on the efficient trade-off between pipeline investment and interruption are made. In our view it is correct that the network owner not NGT should take these decisions. This option provides clarity of roles and responsibilities and this should reduce the need for complex contractual and regulatory arrangements covering the NTS/DN interface.

Management of NTS/DN boundary is an issue under all options. There is a requirement to co-ordinate investment and system operation between the NTS and DNs, notably capacity provision and allocation, constraint management and energy balancing. The Offtake Code is clearly key in this regard and critical under Option 1. In the absence of a

fully termed Offtake Code it is not clear to us whether the contractual and operational complexity required in the Offtake Code will lead to higher costs in this area than the more straightforward interface in Option 2.

Option 2 – Passive DN

Option 2 prevents the development of comparative regulation, which, in our view, will be the key driver of any future efficiency benefits. Although Option 2 minimises the extent of fragmentation, this is better addressed through the governance, agency and other arrangements.

Option 3 – Hybrid DN

This option is a hybrid of Option 1 and contains many of its attributes, although congestion management and system operation generally will be less transparent with the separation of responsibilities for system operation and field operations between NTS and DNs. We agree that this will add additional contractual and regulatory costs compared to Option 1, but these may not be excessive in return for a single SO.

We strongly support a single NTS SO for managing energy balancing across all networks and this is implicit under all options. Under Options 1 and 3, the DN owner contracts for interruption and plans its investment. The difference between Options 1 and 3 is whether NGT acting as SO calls DN interruptions or each DN SO, i.e. multiple SOs.

The Offtake Code will define how the management of gas transportation activities will be split between NGT and DNs. Under Option 1, with NGT and the DNs having individual responsibility for calling interruption, the Offtake Code needs to define rules that co-ordinate interruption between the networks and needs to clearly define the trigger. This should reduce the possibility of disputes arising. For Option 3, even though there is a single NTS SO, the arrangements between NGT and the DNs need to be on a co-operative and non-discriminatory basis. The key is whether the Offtake Code under Option 1 can be designed to provide a proxy for a single SO described under Option 3.

Whatever regime is eventually established we believe that the interruption notification should be centrally managed although we see merit in contracting for interruption with the DNs. Whether this requires DN owners to develop their own interruption arrangements and in turn offer flexibility to NGT on a different basis should be considered as part of the proposed Exit Capacity RIA.

Conclusion

At this stage we favour Option 1, principally because it provides greatest clarity of roles and responsibilities and their management and the expected benefits of a DN sale are theoretically better delivered under this option. However, our support is based on the following assumptions:

- Agency and governance arrangements that constrain the extent of market fragmentation are implemented;
- A single SO for energy balancing;
- A co-ordinated approach to constraint management, approximating to a single SO;
- A co-ordinated approach to system planning and emergencies;

We hope these views are helpful and would be happy to discuss the issues further.

Yours sincerely

Charles Ruffell
Economic Regulation