

Association of Electricity Producers
NGT – Potential Sale of a Network Distribution Business
Comments on Regulatory Impact Assessments: Agency and Governance Arrangements and
Allocation of Roles and Responsibilities between Transmission and Distribution Networks

The Association of Electricity Producers welcomes the opportunity to comment on these regulatory impact assessments. We consider that consultation on these documents provides an important opportunity to comment on the various options under consideration and we welcome Ofgem's commitment to undertake a regulatory impact assessment on the options for reform to the exit capacity regime.

The Association would like to reaffirm its support of the principles outlined in the paper submitted to Ofgem with the support of MEUC and The Gas Forum in March. The high level principles for a DN sale are listed below:

- Not adversely affect gas customers
- A uniform Network Code (no short form codes)
- Common pricing methodologies across all DNs
- Efficient operation of the UK gas network as a whole
- Single and complete interface for all services currently provided by Transco eg credit, invoicing and information flows
- On-going accountability to stakeholders of any agency arrangements with clear incentives to control costs
- More wide ranging changes to the exit regime should be allowed to evolve separately recognising whichever structure that is adopted to allow a sale to proceed
- Safety should not be adversely impacted

These principles aim to ensure that the interests of all customers will be protected. The Association is mainly concerned with the potential impact on CCGTs and CHP schemes connected to the distribution networks. These may be owned and operated by shippers or face some degree of pass thru of charges in their supply contracts. We therefore have a particular interest in shipper costs and transportation charges in addition to any scenarios that might require changes to the contractual arrangements with the customer. In respect of the benefits that might arise from the sale of a distribution business we would expect Ofgem to ensure that any benefits that do arise are shared with customers and that customers are protected from any short or longer term escalation in costs that may occur. We therefore consider that the compensation safety net that Transco may be willing to provide should form an essential part of the consent for sale.

Allocation of roles and responsibilities

The Association agrees that it is important to allocate roles and responsibilities in a way that provides clarity and accountability. However we also share the industry's concern over the potential for fragmentation. In our view this should also be considered in the roles and responsibilities paper and not only the agency paper.

For example a feature of option 1 is that the network operator shall contract with customers / shippers for interruption. This means that customers connected to the distribution network will be contracting with a different party than previously, and clearly represents an example of fragmentation that is not

addressed by the agency paper. It is also the case that this will increase the contractual complexity between customers / shippers and the network operators, yet the document only considers contractual complexity from the perspective of the network owners.

The Association agrees that efficient system planning, operation and security of supply are key issues and whilst there are strong arguments for each network owner having responsibility for these issues with respect to its network, we have ongoing concerns over how these activities will be co-ordinated at the NTS / DN boundary. We understand that such arrangements should be covered in the offtake code but consider that there are many issues still outstanding that must be resolved with minimum complexity.

The Association agrees with Ofgem that a significant proportion of the potential savings that could arise from a sale are not associated with the allocation of roles and responsibilities but from changes to support services and workforce management that will be the responsibility of the DN regardless of which option is adopted. It would be useful to understand what proportion Ofgem expects this to be. Ofgem notes that if only one body was responsible for system operation then benefits associated with the innovative provision of system operator services would not be subject to comparative regulation. Whilst we agree with this, it might be helpful to explore what these services might be and how divergence and fragmentation of processes would be considered if such a change were proposed. If only one body (Transco) is to be responsible for system operation we consider it important that such system operator services are regulated.

The Association would also welcome some clarification on the costs arising from any loss of economies of scale, particularly in relation to the need under option 1 for IDNs to establish their own regional control centres. Ofgem has stated in section 3.20 that *Ofgem will not allow additional costs associated with losses of economies of scale to be passed through to customers.* Also in 6.17 *Any buyer will need to factor any such costs into its purchase decision and Ofgem will not allow these costs to be passed through to customers.* We understand this to mean that any purchaser will have to fund the setting up of a regional control centre itself, it will not be allowed to offset these costs against any benefits that might arise and hence reduce the benefits what customers may see. We consider this approach to be appropriate since customers have already funded the establishment of regional control centres and their relocation to Hinckley, with the expectation of efficiency gains in the future.

Agency

The scope of the Agency will influence the way in which fragmentation of industry processes is minimised and will be a key determinant of the costs that shippers will incur if the sale of one or more distribution networks proceeds, hence also the costs that customers will incur, although competition may minimise the extent to which these are passed on. Therefore it is crucial that any detrimental impact on supply competition is avoided.

From the information presented on shipper costs it is not possible to determine which option shippers consider to be the least cost option although all the agency options present cost savings over the 'no agency' option.

The Association supports the principle of the governance entity to avoid discrimination in network code processes and to provide administration for charging methodology administration. However we have some concerns over how it will be funded from 2007 and how it would be able to access the skills and expertise within Transco and the DNs without having to duplicate these resources in order to be able to provide the 'value added' aspects of the governance process, such as chairing meetings and preparation of modification reports.

Governance

The Association considers the governance arrangements to be central to avoiding the fragmentation of industry processes and divergence of charging methodologies that could result in significant cost escalation for shippers and hence customers in the future. We are disappointed that this section does not provide greater comfort on this issue nor an update on Ofgem's views on the uniform network code.

Please do not hesitate to contact the Association if you would like to discuss any issues raised in this response further.

Association of Electricity Producers

First Floor

17 Waterloo Place

London

SW1Y 4AR

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