



Sonia Brown
Director of Transportation
Ofgem
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17th May 2004

Dear Sonia,

“Allocation of Roles and Responsibilities between Transmission and Distribution Networks Regulatory Impact Assessment”

Our central concern is that the benefits from the sale are actually realised and passed on to consumers and that the savings go to different classes of customers on an equitable basis.

energywatch supports the development of industry structures, conduct and performance which will enhance consumer welfare. Equally, **energywatch** will oppose changes which damage consumer welfare. It is also the case that **energywatch** is not pre-disposed to any particular form of transportation industry structure. In fact Appendix 3 of the RIA shows convincing evidence that there are a number of industrial structures evident world wide which provide effective consumer services.

Passing on the Savings

The RIA compares the potential savings of each of the proposed options. However this is relevant to consumers so long as they actually receive the estimated benefits. Ofgem's proposed mechanism for the transmission of benefits to consumers appears to be a future reduction in allowable opex. **energywatch** regards this as a wholly inadequate means of either securing or transmitting benefits to consumers. In Ofgem's recent analysis of competition in domestic markets Ofgem concluded that markets are “not yet mature.” We do not believe that the level of competition in retail markets is sufficiently strong to guarantee an actual transfer of the savings made by shippers from reduced transportation fees to consumers.

When a comparator is a true comparator?

The argument central to realising savings from the sale of NGT's network rests on the ability of the regulator to compare network performance. However this approach can only work if the networks are truly comparable. Given different network characteristics it might be harder to equitably compare different operator's performance. If a unit cost approach is taken it might obscure the differences in underlying costs as a result of regional diversity.

It has also been argued that there is ample scope for the management teams to develop their own strategies and these will lead to cost savings. We agree this is a possibility. However it might be harder to compare the performance of the networks in the medium term if management teams

make fundamentally different investment decisions. Equally if investment strategies remain broadly similar the potential advantages of diversity will be reduced (and not dissimilar situation if they not merged).

We would not want a situation where imperfect comparators passed on imperfect savings to an imperfectly competitive market.

Cost migration through the supply chain

During the course of the consultation process it became evident that a number of shippers felt their costs would increase. Equally, NGT provided a large amount of evidence there would be cost savings as a result of the sale. Since it might be that both shippers and Transporters could be correct in their assumptions the analytical question has to focus on who is best able to innovate and reduce costs for a given function for the benefit of consumers.

Liability chains

The network sales will create contractual liability between the NTS and the DNs where they did not exist before. The contractual design between NGT and the DNs is therefore critical. We would not want to see largely pointless legal actions between Transmission and the DNs if there was any ambiguity in the drafting of the terms of sale.

Conclusion

We note that changes in the industry structure will, to some extent, generate direct costs to consumers. These costs could arise from the need for consumers to modify systems or to accommodate to new tariffs or changes to interruptible contracts.

We are particularly concerned with the problems faced by medium to large gas consumers who experience volatile transportation charges. This volatility would be further exacerbated by the sale of the networks. This problem needs to be dealt with. Consumer groups urge the use of the electricity model where changes are implemented only at certain agreed times in the year. We would welcome a direct response to this point.

energywatch is willing to elaborate on these points. Please do not hesitate to contact me if you would like to discuss.

Yours sincerely

Lesley Davies
Director Policy and Research
energywatch