

**National Grid Transco – potential sale of network distribution  
business**



**Response to Regulatory Impact Assessment – Allocation of roles and  
responsibilities between transmission and distribution networks**

## **Introduction**

United Utilities welcomes the development of the RIAs by Ofgem as part of the consultation process on the sale by NGT of some of its DNOs

## **Options for roles and responsibilities' allocation**

Of the three options under consideration, we believe that Option 1 most clearly meets the objectives of the key stakeholders. We support your initial assessment that Option 1 has clear advantages over Options 2 and 3 in both quantitative and qualitative terms. We do however have reservations regarding your approach to loss of economies of scale.

As a potential purchaser of a DN, we believe the key issues are accountability and efficiency. Option 1 most clearly addresses these.

- **Accountability.** We believe that it is essential that a DN owner has as much control over meeting its statutory and licence obligations as is practically possible. Option 1 places accountability for operation and planning functions for each network with the network responsible for delivery. This may enable a DN to innovate in the way that it carries out system planning, supply/demand balancing and control of gas flows. Furthermore, it avoids the risk of a DN being placed in breach of its statutory or licence obligations by the failures of a third party, that it had not chosen and did not directly control, to deliver these obligations. Either Option 2 or 3 could potentially lead to a highly litigious environment given the blurring of accountability and responsibility. This could increase contractual complexity, lead to disagreements and disputes that would necessitate regulatory involvement and involve additional expense across the industry which would ultimately be borne by the consumer.
- **Efficiency.** The greater the degree of control and responsibility which a DN owner has over its operations the greater the scope that DN owner has to operate and manage its business more efficiently and economically. This has clear benefits for the DN owner itself, the regulator in terms of comparative regulation and for shippers and consumers through improved services and reduced costs.

From the perspective of shippers and consumers the key issues are presumably quality of service and cost. We believe that for the reasons we have outlined above Option 1 is most suited to meeting these objectives as it best enables DNs to deliver an improved and efficient service over the widest range of operations and provides the greatest potential for cost savings.

## **Calculation of costs and benefits**

United Utilities notes the use of 4.3% as the annual rate of reduction DNs can achieve in its controllable operational costs between 2008 and 2022. Our understanding is that 4.3% is simply the figure that has been estimated for DNOs. This appears overly aggressive to us as an estimate of continuing cost savings for 14 years and we trust that this is illustrative only and not setting a precedent or benchmark.

## **Loss of economies of scale**

We are concerned that losses of economies of scale will not be allowed, for example an IDN owning its own control centre, even though these may be required to achieve the benefits arising from DN sale. In this case, the losses of economies of scale may well be both efficiently incurred and for the ultimate benefit of customers. There is a lack of clarity, in particular over how operating costs will be calculated at the next review. It would be iniquitous if cost efficiencies were taken away and the efficiency frontier then set ahead of the most efficient company because its costs included an element of loss of economies of scale. Furthermore, it is unclear how Ofgem will deal with a situation where, for example, a DN spends capital for a control room that it can operate at below the Transco charge. This appears to introduce an unacceptable level of uncertainty into the regulatory process.

We believe that the fundamental principle which should determine the treatment of investment and expenditure by a licence holder for price control purposes is: was it efficiently and economically incurred in order to meet statutory or licence obligations or for the benefit of consumers?