

Andy MacFaul
Head of Government Affairs
Ofgem
9 Millbank
London SW1P 3GE

Tim Tutton
UK Director of Regulation

tim.tutton@ngtuk.com

Direct tel +44 (0)1926 653140

Direct fax +44 (0)1926 656520

4 March 2005

Dear Andy

Ofgem Proposed Corporate Strategy and Plan 2005-2010

We welcome the opportunity to comment on Ofgem's Proposed Strategy and Plan.

We agree that maintaining the previously identified themes provides useful continuity and aids predictability to the regulatory agenda. Our comments on the particular content of the themes and their translation into a plan are set out below.

Creating & Sustaining Competition

We agree with Ofgem that there are encouraging signs that the market is bringing forward the necessary investments to secure future UK gas supplies. However, we also note Ofgem's concern about increasing market concentration. Given that it is at least arguable that, in the context of current wholesale energy trading arrangements in GB, a degree of horizontal consolidation and vertical integration may be necessary to facilitate the large investments which will be required in gas and generating capacity, it would be useful for Ofgem to articulate what it sees as the trade-offs which will be involved in this area.

Offshore data availability

The plan reports Ofgem's intention to consult on reforms to the onshore regulatory arrangements that would facilitate the release of information additional to that which will result from the measures Transco already has in hand in relation to forecast and actual flows of gas onto the transmission network. We support the principle of providing additional market information if there is a positive cost-benefit to the industry in providing it. We look forward to participating in the process which assesses this cost-benefit.

Gas metering

We welcome Ofgem's proposal to consult during the first quarter of 2005/06 on a framework for a review of competition. The gas metering market has changed significantly since the start of the current price control period in April 2002, with the implementation of the revised gas metering arrangements in July 2004 marking another major milestone in the development of a fully competitive metering market. Although no other specific activity is identified in the plan, we hope Ofgem will make further progress with this review during 2005/6. In particular, it is important that the market review is completed before deciding whether a further period of tariff cap regulation is appropriate for licensed gas metering.

Gas connections

The corporate plan states Ofgem's intention to consider what further action is needed in the connections area. Given that the development of competition in connections has been patchy, with little interest in lower value and one-off domestic connections, it should be considered whether domestic customers' interests would be better protected by competition or regulation. In either case, we are keen that any change in the strategic direction Ofgem plans (from the presumption that competition will offer the best protection) builds on the significant work already taking place with regard to improving customer protection through new service standards - and is also aligned with market and statutory fundamentals (notably the restrictions on Independent Connection Providers arising from the New Roads and Streetworks Act).

Regulating Network Monopolies

In terms of delivering the network investment that will be required over the next five years, we agree that the development of incentives for network owners will be key. You make reference to the need for efficient and innovative solutions and this will require further shifts from the simple RPI-X incentive to minimise operational and investment costs to arrangements that reward delivery of those outputs required by customers.

As well as this important policy work, and the other activities required as part of the transmission price reviews, it is likely that Ofgem will also face a sustained work load as the result of code and charging modifications brought forward as industry participants gain experience of, and seek to refine, the arrangements following introduction of BETTA and gas exit reform.

Transmission review

For the development of incentives, as noted in the plan, the next two years will be particularly important as new price controls for gas and electricity transmission are developed. Whereas we note that there are substantive 2005/6 budget allowances included in Ofgem's plan for Regulating Network Monopolies, and details are provided for generic work items such as incentives and charging, it would be helpful for the purposes of our planning to see how Ofgem anticipates it will resource the transmission price reviews including the electricity transmission mini-review as a project. We believe that there may be a typographical error which attributes anticipated spend for the electricity transmission price review to the electricity distribution review.

Transmission charging & commercial arrangements

The setting out of Ofgem's objectives for the approach to network regulation is helpful and the emphasis on making network operators more responsive to the needs of customers clearly links to the requirements for cost-reflective charging. We value the continuing debate with Ofgem and the industry concerning this linkage.

We support the objective of making entry and exit arrangements appropriately simple. In particular, it may be useful to review the role of generic unit costs and the role of standard delivery times for new capacity, against the background of, in particular, changes in the pattern of supply and demand (which can significantly affect the costs of reinforcing particular parts of the gas and electricity transmission systems) and uncertainties about the time needed to secure relevant planning consents. The arrangements proposed for transmission investments to accommodate renewable generation (TIRG) introduce useful new features in this respect and introduction of such features in other areas where access products are auctioned would bring significant benefits, not least to those who must share in the buy-back risks.

Offshore transmission networks

Like many industry members, we keenly anticipate the publication of details of the regulatory regime for offshore networks for connecting wind farms. Whereas the corporate plan mentions the priority being given to this, details of the anticipated timescales would be very helpful.

Transmission disconnections

We agree that the new quality of service incentives implemented for NGC with respect to demand disconnections are an important advance. As well as extension of these incentives into Scotland, we would also highlight the need for consistency of incentive arrangements in respect of generation disconnections (CAP048 refers).

Gas distribution price review

On the distribution price control we agree with Ofgem that significant network investment will be required over the forthcoming price control. This increase in both capital and replacement expenditure, combined with the likely financial impact of the Traffic Management Act, will require further refinement of vanilla RPI-X regulation. We also note that the current linkage between regulated distribution revenue and the volume of gas transported creates a “weather dependency” for income which bears little relation to performance or cost.

Distribution network sales

We recognise the significant efforts by Ofgem and other industry participants in developing the process for the proposed sale of gas distribution networks leading up to Ofgem’s conditional approval. We look forward to a successful conclusion to the network sales process and customers subsequently enjoying the benefits that will ensue.

The new arrangements at the NTS/DN interface and associated incentive schemes will be a key development because they will be the mechanism for driving efficient investment across the NTS and DNs. There remains considerable work required in this area to progress the necessary code and market rule changes.

In addition, one of the significant industry changes resulting from network sales is the creation of the centralised Agency role which is to be fulfilled by xoserve. It will, therefore, be important to consider how this new industry participant may be most effectively used and regulated.

Protecting the security of Britain’s energy supplies

The corporate strategy mentions how there is an important cost-benefit judgement to be made and how Ofgem seeks to avoid the risk that consumers are required to pay excessive costs in order to ‘gold plate’ infrastructure. However, an important part of the debate must also be to identify how the three strands to delivering security of supply (availability of supplies, adequate network infrastructure and correct system operation) interact. In particular, decisions to delay infrastructure until need is more certain will often be associated with a risk of higher system operation costs should physical network capacity lag the development of new supply sources. This could be a particular issue should capacity to accommodate new renewable generators in Scotland fall out of step with generation development.

European legislation

We agree with Ofgem's strategy with respect to seeking the wider implementation of the liberalisation directives and ensuring that any moves towards harmonisation and security of supply do not undermine our domestic market arrangements, competitiveness or the successes in the UK.

To achieve this, we believe it would be helpful for Ofgem to lead on producing detailed impact assessments of EC proposed legislation to ensure coherence and consistency among existing and proposed legislation.

Helping to protect the environment

We welcome Ofgem's intent to enable companies to deliver environmental improvements in an efficient manner. We support the Government's efforts to address the issue of climate change, and look forward to continue working with Ofgem to develop the regulatory incentives in which a low carbon economy can be achieved. In particular we believe that there are three areas in particular where developments should be considered:

- a) regulatory arrangements, similar to the Innovation Funding Initiative introduced for DNO's, that would encourage R&D and innovation by network companies in environmental improvement measures;
- b) arrangements that support environmental improvement investments that address green house gases not yet covered by the EU's emissions trading scheme (e.g. to reduce methane and sulphur hexafluoride emissions); and
- c) regulatory arrangements that will facilitate the early changeover to electricity driven gas compressors.

We hope these comments are helpful and look forward to seeing the final plan.

Yours sincerely

Tim Tutton