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Dear Paul,

Assessment of the Electricity Distribution Price Control Review Process

Introduction and general comments

British Gas Trading (British Gas) welcomes the opportunity to respond to Ofgem's consultation on the assessment of the electricity distribution price control review process and is happy for this non-confidential response to be placed in the Ofgem library.

Our overarching view of the DPCR04 process is that, whilst there were some welcome improvements from DPCR03, there remain a number of deficiencies that Ofgem needs to address in its work leading up to the next review. The key ones include the:

- appropriate level of transparency;
- extent to which effective regulation of network monopolies is developed;
- lack of clear and consistent incentives;
- failure to achieve early resolution of key issues; and
- compression of formal consultations in the late stages of the review.

We expand upon our concerns in the following sections as outlined in Ofgem's consultation and use Ofgem's paragraph numbering for ease of reference.

General principles and objectives

3.4 *Whether the objectives of the review were appropriate?*

We generally agree that the objectives set out in paragraph 2.1 and 2.2 were appropriate for the DPCR.

However, we suggest that Ofgem's principle objective to protect the interests of present and future consumers, wherever appropriate by creating and sustaining competition and by effective regulation of network monopolies, should have been included as an overarching objective.

Whether Ofgem's processes facilitated the effective delivery of these objectives?

We believe that Ofgem has only been partially successful in achieving effective delivery of these objectives and offer the following examples where we believe Ofgem has not been successful.

- *Effective regulation of network monopolies.* During the DPCR04 we argued strongly for the introduction of price controls for the connection market where the DNOs currently have around 90% market share. The failure to do this represents a failure of this objective.
- *Clear and consistent incentives to DNOs to develop and operate their networks in an economic, efficient and coordinated manner.* Differential incentives between opex/capex will not achieve this objective, instead it has the potential to lead to opex substitution and inappropriate opex reclassification which cannot be fully rectified by a better reporting framework.
- *Early resolution of key policy issues.* The late resolution of key policy issues including pensions, cost of capital and tax provided unnecessary uncertainty and also reduced the effectiveness and quality of the consultation debate.
- *Finance an efficient level of expenditure and ensuring the longer term security of supply will be maintained.* As no justification was given for the doubling of the capex programme, it is difficult to know whether either of these objectives will be met.
- *Provide appropriate incentives to connect and utilise DG.* There is no way of knowing if Ofgem has achieved this objective as no justification of the incentive rates has been provided.

The manner in which Ofgem attempted to achieve these objectives conformed to the principles of good regulation.

We note that in developing network price controls Ofgem has endeavoured to follow the principles laid out by the Better Regulation Task Force which state that “regulation and its enforcement should be **proportionate, accountable, consistent, transparent and targeted.**”

Transparency. This was our primary concern during the DPCR04 process and one that we believe that Ofgem could do much to improve by way of explaining its rationale and reasoning. For example, no explanation was provided as to why Ofgem decided to double the capital programme; the consultants report was published post final proposals. Supplementary information was not forthcoming, for example, with regard to losses, Ofgem proposed that the losses targets be based on historical performances but according to a new definition of regulated losses. Inadequate information was provided to calculate the annual change and, despite our requests, this was not forthcoming. Barring non DNOs to participate on the working groups and not publishing minutes of these sessions further decreased the transparency of the process.

Proportionality. Given the lack of transparency we are unable to determine whether Ofgem achieved this objective.

3.7 Communication

See above.

3.8 *Workshops*

We believe that the workshops were at the right level and frequency and support the continuation of these.

3.9 *DNO/Ofgem Working Groups*

These were a helpful development but as we were only invited to one of these meetings and as the minutes/agendas were not published, we have concerns about whether all views were covered at these working group meetings. We recommend that these sessions are open to all stakeholders in the future.

3.10 *Preparatory Work*

We believe that the preparatory work was helpful but with so many issues unresolved in the late stages in the process we conclude that Ofgem failed in this process.

3.11 *Use of Consultants*

Whilst consultants are a useful resource for one off projects or unexpected / unplanned work, we support the development of in-house expertise for price control exercises as this usually provides better value for money. We had no direct access to consultants which we believe would have helped in our understanding and challenge of proposals i.e. CEPA productivity work.

3.12 *Consultation Process*

We believe that the consultation process was too compressed in the late stages of the review which resulted in an inferior outcome to the price control exercise. At the working level meetings we found that, in some instances, Ofgem representatives were not adequately prepared and in some cases had not even read our response. It also became apparent that, for some issues, Ofgem had already decided on its position on that particular issue and had moved on to new ones. This restricted the opportunity to influence the subsequent document. We also believe that in some limited cases, our recommendations were not properly evaluated.

3.13 *Requests for, and use of, information*

Not applicable.

3.14 *Timeline*

We believe that the timeline was too compressed in the latter stages, notably in the areas of metering, capex allowance, opex/capex incentives and pensions. This compression led to a reduction in the effectiveness of the consultation process and a poorer final outcome.

3.15 *Regulatory Consistency*

We were generally happy with the level of regulatory consistency with the exception of asset disposals. Assurances were given at working level meetings that this issue would be dealt with but this was not addressed in final proposals. This is a clear

example of poor regulation where DNOs have received significant, unwarranted windfalls.

3.16 *Transparency*

See section 3.4 for our views on transparency failures.

3.17 *Access to Ofgem & the Authority*

Due to the compressed nature of the latter stages of the consultation process we were not happy with the level of access to Ofgem and the Authority. For example, following the September update, Iain Taylor wrote to Martin Crouch with a view to meet and discuss British Gas' high level concerns. However, due to the timescales, the work had been finalised and papers submitted to the Authority, thus making it too late to influence issues. Compared to this, DNOs with regular access to Ofgem influenced the process and policy throughout and therefore we believe the process to have been somewhat biased toward DNOs.

3.19 *Process delivery*

We believe that a factor as to why so many decisions were left so late process is due to not enough resource being available from early on in the process. We suggest that Ofgem ensures that for subsequent reviews adequate resources are in place at the onset to undertake the required work.

3.20 *Positive Points*

We acknowledge there were many positive points to the DPCR04 process and these include:

- Setting policy and process objectives
- Workshops
- The number and detail of the consultation documents

If you have any questions please do not hesitate to contact me on the number given above.

Yours sincerely

Roddy Monroe
Regulatory Issues Manager, Strategy