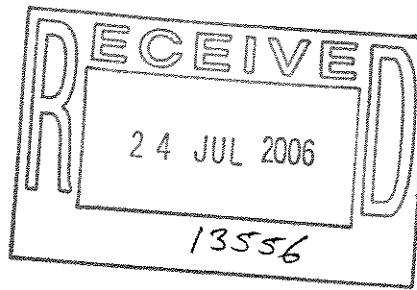


cc: Bob Hull

20<sup>th</sup> July 2006

Mr David Gray  
Managing Director, Networks  
Ofgem  
9 Millbank  
London  
SW1P 3GE



Dear David

### **Gas Transmission Price Control Review Initial Proposals**

Thank you for allowing the Institution of Gas Engineers and Managers (IGEM) the opportunity to comment on the gas transmission price control review initial proposals.

We are disappointed to note that Ofgem have, so far, not asked IGEM for its independent advice for either the gas distribution or transmission PCRs, and do not appear to have considered our previous written submissions, although they have referenced some comments.

IGEM is the independent professional body for the gas industry. It has operated since 1863 and has a Royal Charter to ensure that gas industry knowledge is shared and that professional standards are maintained and improved. It is in a position to offer advice to you solely in the interests of maintaining and improving safety, quality and integrity in the gas industry.

Within the context of the overall review, IGEM's remit is limited to a number of key areas. At the present time, it is felt that some of these areas do not appear to be adequately considered in the reviews. IGEM would be pleased to engage in providing ongoing information and independent advice to create the greatest opportunity for you to make considered decisions. The comments below are therefore an introduction to some key areas that we believe require serious consideration.

#### **1 in 20 Security of Supply Criteria**

The previous transmission consultation document suggested that Ofgem may remove the 1 in 20 security of supply criteria for the NTS, allowing the NTS to react to market signals provided by the distribution networks and directly connected customers.

IGEM is strongly opposed to the removal of the 1 in 20 security of supply criteria as an independent check on the robustness of the capacity requests made to the NTS. The risks to gas supply are more apparent now than for many decades and it would be prudent to strengthen rather than weaken the governance in this area.

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Around ten years ago, the 1 in 50 security of supply criteria for all firm connected loads was removed so that the market could decide the appropriate level of supply security for industrial customers. Ten years later the UK is vulnerable to major supply shortages in the event of sustained colder than normal weather in winter.

This demonstrates the unintended consequences which can occur when the market replaces absolute security of supply criteria.

IGEM is therefore very disappointed and concerned to note that Ofgem have removed £390m of exit related expenditure from the baseline and proposes to deal with this via the use of revenue drivers.

### **Historic Capex**

Ofgem have removed £74m from the NTS asset base having concluded that the previous expansion of St Fergus capacity was unnecessary and inefficient.

Throughout the 40years of NTS history, members of IGEM have designed, approved, constructed and operated the national and regional gas infrastructure. At various times capacity has increased and decreased through different parts of the network. For example Bacton was in decline 10years ago until the decision to build the Interconnector significantly changed the capacity and flow characteristics of the terminal.

Investment decisions are made based on the best available information at the time and in the national interest to ensure gas security of supply to 1 in 20 standards. To retrospectively disallow investment which was made based on the best available information, fundamentally changes the risk and reward balance for the NTS. This will result in two outcomes: system users will be asked to fully underwrite any future investment and the cost of capital will have to increase to reflect the increased regulatory risk that the NTS are exposed to.

### **Non load related Capex**

Parts of the NTS are now approaching 40 years old, with the bulk of the NTS some 30 years old. This is set against an original design life of 50years. It is therefore to be anticipated that certain components of the NTS will be required to be upgraded or replaced at this point in the lifecycle. This particularly applies to the above ground installations such as compressor stations which were designed and installed at a time of different legislative requirements and have given many years of service in an environment that they were not designed for, namely summer exports from the UK requiring year round compression.

IGEM is therefore concerned to note the removal of £142m from the NTS forecasts relating to compressors to deal with emissions legislation and asset replacement. Disallowance of this expenditure could significantly impact the NTS's ability to operate the national gas infrastructure in a way which gives maximum flexibility in the light of future supply location uncertainty.

### **Procurement Efficiency**

Over the last two years, IGEM has hosted several presentations relating to the construction of high pressure steel pipelines. The raw material costs have increased

significantly due to worldwide demand for steel and the Baxter index of construction labour costs is running at 3% to 4% above inflation.

In the future, major civil works programmes such as the 2012 Olympics will continue to put pressure on what is a limited skilled labour pool.

In the light of this, IGEM is perplexed by the 5% procurement efficiency reduction applied by Ofgem.

### **Future Opex**

IGEM notes the proposed £3.6million per annum reduction in engineering opex for the NTS with concern. After many years of opex cuts, IGEM believes that the gas industry has to start to invest in the future. The constant short term focus on opex reductions needs to be set in the context of the long term stewardship of the assets and the human resources. The consequences of the recruitment embargo in the gas industry during the late 1980s to mid 1990s is now starting to have an effect some 20 years later in terms of the lack of professionally competent resources to run the gas business over the next 20 years.

### **Age Profile and Competence**

Various studies in the past have considered age profile in the gas industry. The IGEM membership database shows that the majority of registered professional engineers are over 50 years old. It is to be expected that by 2017 most of these will have retired. Indeed, key competence and skills are dramatically declining, year on year. Competent engineers are a prerequisite for safe operations and the gas industry is an industry where safe operation must always remain the first priority.

Age profile has been recognised as a serious safety and economical issue for many years and, although some positive initiatives have been instigated, the industry does require an overall strategic review to address the problem. This needs to consider building financial incentives into the formula to ensure that companies with licence condition obligations ensure that adequate investment is made to maintain competence and adequate resources in future years. Unfortunately, the principal of allowing the market dynamics to naturally solve this problem is not working.

Ensuring that companies have adequately qualified and certificated engineers and managers would not only aid safety, it should have a noticeable effect on efficiency due to the ability for them to implement best working practice and innovative solutions.

### **Training**

It is anticipated that, as workload volumes continue to grow and senior professional engineers and managers retire, there will be an increasing requirement for training. This is over and above the training required to support the continuous professional development of the existing professionals. IGEM would be happy to support enquiries into efficient methods of ensuring competence and certification.

### **Professional Fees**

IGEM members are accountable for paying their own professional fees. Some companies have a policy of reimbursing professional fees for their registered

professional engineers and managers. IGEM fully supports this policy as we believe that professional accreditation of its employees supports the companies' licence to operate.

### **Technical Standards**

Many of the technical standards used within the gas industry are published and maintained by IGEM. The corporate governance of these standards relies heavily on experts volunteering their time and knowledge. For many years the bulk of these experts have been supported by their companies.

IGEM previously recommended that the companies involved in the reviews were asked to quantify their ongoing commitment to support industry standards on a voluntary basis and to explicitly identify the quantum of this support.

IGEM are in a position to act as an independent holder of industry standards and work with industry to update and maintain them under a fee structure with the Network businesses.

I hope that the above comments are helpful. If you would like to meet to discuss any of these further, I would be happy to travel to London at your convenience. Indeed, IGEM has access to gas industry experts who can provide advice who are independent and not associated with the companies involved in the review.

Yours sincerely



John N. Williams  
**Chief Executive Officer**

Copies to:

Robert Hull, Director, Transmission, Ofgem  
Joanna Whittington, Director, Gas Distribution, Ofgem  
Steve Wing, Head of Gas and Pipelines Unit, HSE