

AW/PW/078

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Ofgem
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Dear Andy

Ofgem Five Year Strategy 2008-2013

I am responding to Sir John Mogg's August open letter on Ofgem's five year strategy. Northern Gas Networks welcomes the implementation of last year's strategy as outlined in the letter, in particular engaging within Europe to push through liberalisation and ensuring that transmission network businesses are appropriately incentivised to invest. The remainder of this response answers the questions raised in your letter focusing on gas related issues, and in particular how to extend some of the valuable work undertaken for supply and electricity network companies into gas distribution.

1. Key challenges facing the industry

Customers continue to want:

- safety
- security of supply
- within these constraints, low and stable prices.

Ofgem's focus must be on delivering these priorities for customers. Thus it is essential that the regulatory environment remains attractive for investors to deliver the requisite safe and secure networks.

Security of supply remains a critical issue and NGN welcomes the initiatives that Ofgem has taken to reduce the risk of supply issues. Nevertheless, the continuing gradual decline in UK gas production will mean that this continues to be a high priority item.

Wholesale gas prices continue to be volatile and market movements suggest that this is not an efficient and effective market. There is probably more that can be done to improve

the effect of competition in setting gas prices and hence providing lower and more stable prices to customers. The market volatility impacts gas distribution networks by making it difficult to predict shrinkage gas costs and results in unpredictable changes in transportation charges thus impacting customers.

Better regulation will continue to be important to ensure that controls on monopoly companies are adequate but that excessive costs and obligations are not imposed.

2. The response the Authority should take to these challenges and the order of priority that it should give to its response

The answer below is laid out broadly in order of priority. 2008 is a year with no price control reviews and hence provides an opportunity for the Authority to focus more attention on key objectives such as providing a leading voice in Europe, security of supply and better regulation.

Continuing to work with the European Commission (EC) is important to bring about market liberalisation which will help ease gas supply issues in the UK and should lower energy prices. A competitive market in the UK alone is insufficient to ensure security of supply and thus further progress needs to be made in Europe. NGN welcomes the relatively tough stance that the EC is currently taking on liberalising markets and “unbundling” supply and distribution. Ofgem should continue to work with the EC to drive policy and to ensure that it is enacted.

It is essential to ensure that the climate is right in the UK for adequate investment to ensure safe delivery of gas and to effectively manage security of supply issues. This means providing sufficient allowances for companies to invest in their networks and that this investment is appropriately incentivised. Furthermore, it is important to ensure that companies are able to finance these investments and that the returns on investment are sufficient to attract investors to network utilities and to encourage companies to invest. Investors also require a stable and predictable regulatory environment.

NGN notes the review undertaken of supply licences and the ongoing electricity distribution licence review and welcomes the substantial progress the Authority has made in easing the regulatory burden on supply companies by removing many licence obligations. This work should be extended to gas distribution networks. The gas distribution licence was developed for expediency during the sale process and there are a number of conditions (for example, requirements for system management principles statements) that are much less relevant for GDNs than for the NTS and where the conditions could be greatly simplified or removed with no implications for customers. Similarly, the metering of last resort obligation is now unnecessary given the development of competition; business separation requirements are unnecessary for networks without supply licences. All these conditions impose burdens on companies that ultimately fall on customers. NGN notes that 50% of energy suppliers' obligations have been removed in the review of their licences and a target should be set for removal of the many gas distribution obligations that do not protect or benefit customers.

It is noteworthy that one of Ofgem's stated successes of 2007 is developing schemes to incentivise investment in innovation in electricity distribution but that such schemes are not included in Initial Proposals for gas distribution.

I hope that you find these comments helpful; I would be pleased to have further discussions on any of the issues discussed.

Yours sincerely

A handwritten signature in black ink that reads "Alex Wiseman". The signature is written in a cursive style with a long, sweeping underline.

Alex Wiseman
Regulation Director

Cc Sir John Mogg

