

Ref: AW/PW/110

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Dear Andy

NGN welcomes the opportunity to provide comments on Ofgem's Corporate Strategy and Plan 2009-14. NGN believes that all seven themes remain valid and we comment below on each of the themes to address your two questions on the relevant issues and Ofgem's approach to the challenges. Our comments are from the perspective of a gas network owner.

Creating and sustaining competition

NGN welcomes Ofgem's active involvement in wholesale and retail markets and Ofgem's probe into retail companies last year. We expect that Ofgem will continue to challenge the levels of prices.

The volatility in the wholesale market is unhelpful for customers and for the stability of retail prices. For gas networks it makes it difficult to predict gas shrinkage costs which results in a danger of substantial over or under recovery compared to allowed revenue each year and also unpredictable changes in transportation charges thus impacting customers. Ofgem must continue to monitor both wholesale and retail markets to ensure that they are fully competitive.

Regulating networks effectively

Monopoly networks require regulation and this can clearly be seen to be working effectively in the improvements being made in customer services and the reductions in costs that networks are making and which will result in lower customer charges.

NGN is committed to benchmark regulation and consequently supports the cost reporting project to ensure that robust comparative information is available. We are actively participating in Ofgem workshops to improve the consistency and hence comparability of cost reporting across the GDNs. We would welcome an extension of benchmarking from costs to customer service and safety. This may result in a further step change in the quality of service delivered by networks to customers.

NGN is a strong supporter of incentive-based regulation. The incentive based approach to implementing Ofgem and Government objectives, for example to improve customer service, encourage innovation, incentivise network extensions to fuel poor communities and reduce methane emissions is enabling behavioural changes that benefit customers. One example is

that two years ago we undertook almost no R&D but the IFI incentive has provided the catalyst for NGN to undertake a number of innovation projects, for example to improve excavation techniques, reduce leakage and develop GIS using Google Earth.

We agree with Ofgem's encouragement of competition where possible but we would point out firstly that competition is well developed in metering and it is unnecessarily onerous to continue to have a meter supplier obligation of last resort on networks. Secondly, connections competition is appropriate providing there is a level playing field in terms of the required level of customer service and safety and also for the remuneration available for undertaking connection work.

We are actively engaged in Ofgem's RPI-X@20 project and we strongly encourage the proposed high degree of consultation and industry involvement. However, it is important to recognise that this regulatory regime underpins the financing of networks and careful consideration must be given to any radical change and the impact that this might have on the financial markets, both debt and equity. The current economic environment has increased the challenge of raising utility finance and any substantive or unexpected change, for example to RAV, may upset the financial markets making the financing of networks even tougher.

The review proposed of IGTs and IDNOs is welcome to ensure that customers are obtaining real and sustainable benefits from the increase in activity of independent network operators.

Sustainable development

NGN is fully supportive of measures to ensure sustainable development and Ofgem's approach to sustainable development is entirely appropriate. The incentives on gas networks to reduce leakage have resulted in even greater focus in leakage reduction strategies such as pressure management. Incentive based regulation has been proven to work and incentivising companies, for example in gas distribution the emissions incentive, network extensions incentive and the discretionary reward scheme, all help to focus companies on the sustainability agenda.

Protecting security of supply

As the UK becomes more reliant on imports, ensuring the security of gas supply becomes more important. There would be a substantive cost in the event of insufficient gas and NGN supports the developments to improve gas import and storage facilities. Consequently we welcome Ofgem's approach in seeking to remove market barriers, and using incentive-based regulation as a means of delivering appropriate outcomes and we look forward to further initiatives to incentivise development of national gas storage facilities.

Leading voice in Europe

We recognise the high profile that Ofgem has in Europe. Ofgem needs to continue to work actively in Europe to promote competition, encourage enforcement of legislation on deregulation and hence ensure that gas is transmitted across Europe on a fair and non-discriminatory basis. NGN also supports Ofgem's stance on full unbundling of transmission networks and we look forward to the full implementation of this European policy. It is important that Ofgem ensures that British interests are recognised and promoted within Europe, continues to push for competitive European markets and that it continues to have strong relationships with all the European bodies, in particular ACER, the new Agency for Co-operation of Energy Regulators.

However, there is a danger over the next few years of a growth in EU regulation of UK networks and Ofgem needs to ensure that conflicting requirements aren't placed on UK companies by regulatory requirements at both a UK and European level.

Tackling fuel poverty

NGN welcomes Ofgem's measures in GDPCR to tackle fuel poverty by incentivising networks to extend networks to the fuel poor and to implement a reward scheme that can contribute to GDN measures to address fuel poverty. However, it should be noted that fuel poor extensions is discretionary spend and that incentives need to be sufficiently strong to ensure companies maintain investment during a period when low or negative inflation, which adversely impacts both borrowing capacity and revenue, is likely to put downward pressure on capex budgets.

Better Regulation

The improvements proposed in Impact Assessments are welcome and in particular the commitment to undertake post-implementation reviews.

It is appropriate to review industry code governance and NGN supports the proposals to improve implementation of strategic reforms and to streamline the process for minor changes to codes. However many of the issues being addressed are in electricity; gas distribution governance works well and is administered efficiently, effectively and independently. Ofgem should be wary of delivering changes in gas to solve problems in electricity governance, for example by insisting on a Board structure for the Joint Office.

Question 4: Are there any areas of regulation that you consider to be an unnecessary burden that should be removed?

Of particular note is the meter supplier of last resort (MSOLR) obligation as discussed above under "regulating networks effectively". Metering is a competitive business and this onerous obligation means that we are required to have a price-capped metering business for an asset base of only 10,000 meters increasing by just 3,000 meters per year. This business will be loss-making for the foreseeable future, it is unclear the MSOLR obligation is needed by customers, and we should not be obliged by our licence to maintain it.

A further obligation on gas networks that seems to us completely unnecessary is the requirement to purchase shrinkage gas. This results in NGN daily tracking gas prices to manage risk against our budget – an activity that seems inappropriate for a network remunerated as a low risk utility. Furthermore, the extreme volatility experienced in the last few years in wholesale gas prices results in volatile and unpredictable charges to customers. It is noteworthy that the electricity DNOs are incentivised to reduce losses without having to make physical purchases of electricity. Now that GDNs have an environmental emissions incentive to reduce leakage, this could easily be increased to cover the cost of purchasing gas and extended to cover theft of gas and own use gas. The incentive on GDNs to reduce shrinkage would be unchanged and the result would be more stable prices as well as a reduction in complexity, costs and risks for GDNs leading to lower costs for customers.

Question 5: Are there any other activities that we should include in the Simplification Plan that we intend to publish in March?

NGN wholeheartedly endorses the simplification plan. Clear and concise regulation should be part of the principles of better regulation and should lead to lower costs for Ofgem and licence holders and hence for customers.

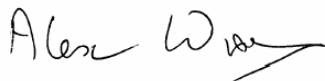
We note that Ofgem "will consider taking forward a review of gas distribution licences in the next year or two". NGN would propose that this is an activity that could (and should) be commenced by the end of 2009 and hence completed well before the next GDN price review. The licence was developed from the previous Transco licence to ensure that the sale of gas distribution businesses was as smooth and as rapid as possible but without full review of the appropriateness of the conditions to a distribution business. This was the correct decision at the time but it has led to a number of conditions within the gas distribution licences that provide little

or no customer benefits but increase the obligations on GDNs. Examples include metering obligations (A10, A43, A46, E5) and system management services (D5). A full review is required to ensure that obligations are appropriate and efficient and that the licence is easy to understand and use.

Ofgem should also consider reducing the information burden on networks as part of its simplification plan. NGN recognises that good regulation requires detailed data from networks and welcomes the gas cost reporting project that is starting to ensure consistency across networks. Nevertheless, we feel that some of the information submitted is never utilised by Ofgem and that less onerous data requirements would prove beneficial to Ofgem and to GDNs without compromising Ofgem's ability to regulate effectively.

I trust that these comments are useful and I would be happy to discuss the contents of this letter further with you if that would be helpful.

Yours sincerely

A handwritten signature in black ink that reads "Alex Wiseman". The signature is written in a cursive style with a long, sweeping tail on the final letter.

Alex Wiseman
Regulation Director

Cc: Rachel Fletcher