

Hannah Nixon
RPI-X@20 consultation – Local Grids and RPI-X@20
Ofgem
2nd Floor
9 Millbank
London
SW1P 3GE

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Dear Hannah,

RPI-X@20 Emerging Thinking Consultation and Parallel Consultation on Third Party Right to Challenge

Thanks you for the opportunity to comment on the two consultations above we recognise at this stage in the review some of the proposals are still under development or consideration we have couched our response accordingly. The key points of our response are:

- **Emerging Thinking Consultation** – we recognise that more detailed proposals will be published in the summer we are generally supportive of the high level principles e.g. enhanced engagement but we will reserve final judgement until we see further details for example what specific elements of a price control Ofgem envisages may receive longer term commitment etc. As Ofgem have noted RPI-X@20 in many instances will be building on developments from DPCR 5 it would be helpful when setting out the detailed proposals if Ofgem can indicate where proposals represent an incremental requirement to DPCR 5 e.g. output measures, BPQs etc.
- On the subject of facilitating competition in energy services (“ESCOs”) NGN is not aware that there is a problem in gas distribution regarding access by such parties to the gas distribution networks.
- **Third Party Right to Challenge** we are like Ofgem are undecided as to whether such a mechanism would be of net benefit to consumers in order to do the proposed mechanism would have to meet three important conditions:
 - the right of the appeal would only be designated to bodies directly representing consumers’ interests;
 - an independent body would assess the validity of third party appeals and decisions on such appeals would be binding (albeit open to formal appeal) not a recommendation to Ofgem; and
 - the introduction of such a mechanism would require new legislation.

On a more general level we are concerned about a number of comments made throughout the RPI-X@20 review regarding the future role of gas distribution specifically in relation to falling peak gas demand and the “electrification” of heat. NGN does not believe the decline in gas demand will be as pronounced as has been suggested in many of these comments, more importantly the future of gas distribution must be carefully considered against the likely scenarios arising from the energy sector reducing its carbon intensity over time key issues here will include the continued role of gas as a back up for peak heating demand with increased levels of intermittent generation and whether the displacement of gas is efficient

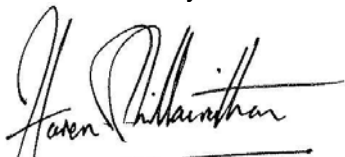
and truly of lower carbon intensity. The GDNs and the ENA have recently commissioned a study into these issues and we intend to feed in this work into the RPI-X@20 review amongst relevant Ofgem consultations.

Our responses to the specific questions raised in the consultations are attached to this letter:

- Appendix 1: Emerging Thinking Consultation
- Appendix 2: Third Party Right to challenge Our Price Control Decision

We have submitted a separate response to the parallel consultation embedding financeability. Please let me know if you would like any clarification of any aspect of this response. Our response can be regarded as non-confidential.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Haren Thillainathan', with a horizontal line underneath it.

Haren Thillainathan
Regulation Manager

APPENDIX 1 Regulating Energy Networks for the Future: RPI-X@20 Emerging Thinking

Chapter 2: An outcome led framework

Question 1: Do you agree that a new regulatory framework should focus on delivery of desired outcomes?

Yes

Question 2: Do you have any comments on the categories of outputs related to these outcomes?

The possible outputs identified in the Emerging Thinking paper are:

- reliability (of network services and the wider energy system);
- safety;
- environmental targets, particularly delivery of low carbon energy services;
- conditions for connecting to network services;
- customer satisfaction; and
- network-related social obligations.

All of these outputs exist in some form within the present regulatory framework for gas distribution and NGN supports the further development of these outputs. We are encouraged by Ofgem's statement that it will seek build on existing outputs framework within each sector we believe this is the most expedient route to develop outputs that are targeted to improve outcomes for gas consumers. We also welcome Ofgem's recognition that outputs would have to be consistent with requirements of other authorities for example safety and the HSE.

Question 3: Do you have any comments on how these outputs should be incorporated into the new regulatory framework?

There are a number of key considerations that should be applied across all areas of the regulatory framework where the above outputs may be incorporated e.g. business plans, incentives, baseline service delivery etc.

- **Measurability/observation** – This applies for quantitative and qualitative outputs it is essential that performance on outputs can be reasonably determined before integrating them into the regulatory framework otherwise there will be an element of regulatory risk. A good example of this are the network output measures introduced for the DNOs as part of DPCR 5 some outputs such as fault rate are fairly straightforward to record and target. This is more difficult in other areas where international asset management is more nascent e.g. network wide health yet Ofgem have still asked the DNOs to make a commitment in relation baseline revenue on the basis that the measures will be developed during the price control period and failing that Ofgem may use a high level qualitative review. This introduces a large degree of uncertainty regarding the assessment of such outputs at DPCR 6 this could impact will investment decisions which may not be to benefit of consumers.
- **Influence** – another important issue is the degree to which network companies can influence or impact certain outcomes and outputs. This can be in terms of identifying and understanding the actions a network company can make to change an output for example it is simpler to see how a network can improve performance of an individual asset but this is more difficult to ascertain for the performance of an integrated network this may affect the robustness of business plans or a company's response to incentives for such outputs.

This issue may also arise in relation to the regulatory/legislative framework for example in order to facilitate the connection of biogas to gas distribution networks and number of regulatory, statutory and technical issues need to be resolved NGN

has taken a pro-active role by identifying these issues and seeking to progress them with Ofgem and other relevant authorities. This contrasts with the distributed generation (DG) in electricity where many of these issues have been resolved. Given this background Ofgem might adopt a framework that recognises that more innovation is required from GDNs to connect biogas at this stage whereas it takes an incentive based approach focussed on cost and volume of DG connections, for DNOs reflecting different forms of influence required from networks in each sector.

Chapter 3: Effective Engagement and Accountability

Question 1: Do you agree that it is appropriate for network companies and Ofgem to improve their engagement with stakeholders as a way of improving the quality and legitimacy of decision making? Do you have any ideas on how to improve engagement by network companies and Ofgem?

Yes NGN will always support any measures where practical, that increase engagement with key stakeholders. This will help to ensure that price control proposals are more likely to maximise the benefits to consumers and other key stakeholders. We hope Ofgem will provide guidance for companies on the form and level of consumer engagement it believes will be beneficial to price review process especially if companies are to be rewarded or penalised in price control review for such actions.

Question 2: Do you think we should consider introducing a third-party merits-based right to challenge our final price control proposals?

Our comments regarding the rights of third party appeals to price reviews are set out in our response to the parallel consultation on the subject in Appendix 2.

Chapter 4 Incentivising efficient long term delivery

Question 1: Do you have views on our suggestion that financial commitments could be provided for longer than five years for some elements of the price control? What would be the appropriate length of this partial „longer" period? To which aspects of the control might it be appropriate to give a longer-term commitment?

We assume what Ofgem has in mind are specific areas of expenditure and associated incentives and financing parameters rather than generic elements the overall price control e.g. cost of capital. If this is the case we do not believe that there are areas that would warrant such treatment in gas distribution there are unlikely to be large enough capital projects and large programmes such as mains replacement are best regulated under the present regulatory framework it is difficult envisage that the interests of consumers or network licensees would be better served by less frequent reviews of such programmes.

Question 2: Do you have views on our suggestions on what business plans might look like in the new regulatory framework?

Again it is difficult to comment without a specific example of what Ofgem has in mind here. In general we would expect that Ofgem would set out a framework of principles and guidance for companies regarding the requirements of relevant business plans and then network companies would respond with longer term business plans where they thought the general criteria would be met.

Question 3: Do you have comments on our ideas on how efficient costs might be assessed in the new regulatory framework?

The types of evidence alluded to e.g. comparison to competitive/efficient benchmarks etc seem sensible and consistent with the present cost assessment of the price control baseline allowances.

Question 4: Do you have comments on our ideas on how efficient long-term delivery might be incentivised in the new regulatory framework?

No

Question 5: Do you have comments on our suggestions of how the new regulatory framework might encourage network companies to anticipate and deliver on the needs of existing and future consumers and network users?

Again we will await further detail before making specific comments. The key issue will be for companies to provide robust evidence of the need they are anticipating and responding to, however once Ofgem has effectively agreed to the expenditure it cannot then penalise companies if the anticipated need does not materialise to the extent envisaged. One would imagine that the regulatory framework would recognise that there may be future use of the asset. For example it may be that gas transmission and distribution pipelines built now for transportation reasons may have future use as strategic storage or CCS.

Question 6: Do you have views on our ideas on how the interactions between charging and price review incentives might be taken into account at price reviews?

In principle we agree with the ideas suggested by Ofgem however Ofgem would need to ensure that these are consistent with other objectives has placed on network charging e.g. consistency between distribution companies, cost reflectivity, facilitation of competition etc,

Question 7: Do you have comments on our suggestion to treat companies differently at the price control, both in terms of process and incentives, reflecting planning and delivery performance?

We need to see more detail here preferably with examples before being able to comment specifically. However one observation we would make at this stage is that the task of determining and ranking "overall" performance does not seem straight-forward especially where Ofgem is combining objective measurements e.g. cost efficiency benchmarking results and more subjective judgements e.g. the level of customer engagement. Furthermore once Ofgem determined overall performance how would this be reflected in the treatment of companies? would there be a "blanket" treatment across every area of the price control or would it be applied accordingly to individual areas? how much differentiation would there be especially where overall performance was close especially mid ranking companies? Rather than ranking and treatment of companies on an overall basis Ofgem may achieve the same results by calibrating the treatment and incentives on network performance for each individual area of the price control e.g. the IQI mechanism for capex.

Question 8: Do you have views on our suggestion to open up some aspects of delivery to competition?

Whilst we agree with principle we think the gas distribution sector is already a strongly competitive market as demonstrated consistently in Ofgem's Connections Industry Reviews (CIRs). NGN faces strong competition for network extensions and connections from independent gas transporters (IGTs) and utility infrastructure providers (UIPs). Given this background it is difficult to see what additional benefits to consumers would be delivered by measures such as compulsory tendering over and above the existing competitive market.

Question 9: Do you have comments on the design of a cross-sectoral time-limited innovation stimulus that is open to a range of parties?

The potential approach outlined in the supporting paper has merit and builds on the Low Carbon Network (LCN) fund. The inclusion of third parties to compete for funds may also be beneficial, one example relevant to NGN is bio-methane projects there are lots of opportunities for Ofgem to partner other parties e.g. suppliers, water companies, agricultural businesses etc and develop designs and processes that will be applicable for connection in bio-methane in future.

Question 10: Do you have comments on our straw man on how we would embed our financeability duty into the new regulatory framework?

We have commented specifically on these issues in our response to the parallel consultation on the subject which we have submitted as a separate response.

Chapter 5: Cross-sectoral solutions for a sustainable energy sector

Question 1: Do you agree that a new regulatory framework can deliver our desired outcomes within the existing industry structure?

From a gas distribution perspective our experience to date is that the existing regime deals with the issues raised notably facilitating competition in energy services (see below).

Question 2: Do you agree that it is appropriate to encourage network companies to work with others to identify cross-sectoral solutions to the challenges the sector faces?

Yes we cross sectoral solutions should be encouraged where this is something NGN has encountered with respect to bio-methane for example working with water companies and energy suppliers. One measure that would facilitate the connection of bio-methane would be an incentive directly on GDNs in the same way electricity distribution has incentives to connect distributed generation.

Question 3: Do you agree that the regulatory framework should ensure energy network companies facilitate effective competition in energy services?

In our view the current regime does facilitate effective competition on energy services with respect to offering such companies ("ESCOs") access to gas distribution network in general network access has not been an issue to date in gas distribution. It should be noted that at present there very few parties if any that could conceivably be described as ESCOs in the gas distribution sector.

APPENDIX 2 RPI-X@20 Parallel Consultation: Third party right to challenge our final price control decisions

NGN's starting position on this subject is that the present price control framework does afford third parties the right of appeal notably:

- representations to the Secretary State to review final proposals
- requests to Ofgem to refer price control proposals to the Competition Commission (CC) as with network companies, and
- judicial review

We accept that these routes may not be clearly defined or present certain hurdles to particular stakeholders in using them therefore there may be benefit by introducing a mechanism of third party appeal subject to three important conditions:

1. the right of appeal is designated to specified bodies that directly represent consumer interests
2. the role of "gatekeeper" to the appeals process should be undertaken by an independent body (to Ofgem) e.g. CAT. Furthermore decisions on any such appeals by the Competition Commission should be binding whilst open to formal appeal, not a recommendations to Ofgem;
3. such an appeals mechanism would require new legislation to be robust and legitimate,.

Even with these caveats we like Ofgem, are undecided whether a third party appeals mechanism would deliver *net* benefits to present and future consumers this would have to be demonstrated before taking any action in this area.

The key issues in such consideration will be the extent to which consumers will directly benefit from the parties that are able utilise such an appeals process. It is not unreasonable to assume that bodies that directly represent consumers' interests may not utilise an appeals mechanism as successfully as other stakeholders such as energy suppliers. One can not presume stakeholders such as energy suppliers will pursue interests that are aligned to those of present and future consumers, this supported by evidence including Ofgem's own Energy Supply Probe. This argument was acknowledged in airport regulation where the right of appeal has only been designated to Passenger Focus and airlines were consciously excluded. For these reasons we believe the first condition above is essential if benefits are to be secured for consumers.

Chapter 2

Question 1: Do you have any views on the potential advantages and disadvantages of a third party merits-based right of challenge? Are there any factors that we have not identified or considered?

Advantages and disadvantages listed on pages 7 and 10 respectively appear to capture most of the key issues.

We have a couple of comments on the potential advantages firstly and perhaps most important who will be able to take advantage of a third party appeals process? Ofgem has assumed in all of its discussions that consumers will benefit however NGN believes this will come down to which parties have sufficient resources to make successful appeals. In previous papers on this subject Ofgem has referred to the appeals mechanism in telecoms via the Competition Appeals Tribunal (CAT) the evidence of appeals to date tends to suggest that parties who have appealed are generally competitors or have a commercial interest in the companies' tariff controls that are being appealed, it is not clear that any gains or concessions secured by appellants are directly passed to telecoms consumers. If we transfer this precedent to energy network price controls the most likely parties to successfully use an appeals process are energy suppliers in the particular "the big six". Ofgem has previously acknowledged this fact and implied in such circumstances that energy suppliers' interest could be taken as proxy for that of consumers. However the there is

much evidence to suggest that suppliers own commercial objectives will be before those of consumers this is clear from Ofgem's own Energy Supply Probe investigation. Furthermore there is no evidence to demonstrate that energy suppliers have any consideration for the interests of *future* consumers.

Another key issue is the role of "gatekeeper" as Ofgem term it i.e. the body that will assess whether appeals should be determined under the appeals process. NGN believes that the potential advantages will be maximised this role should be performed by a third party analogous to CAT. Firstly this would maximise the incentives on both network companies and Ofgem to engage sufficiently with stakeholders and agree price control proposals that benefit all stakeholders. It is important that such incentives apply equally to Ofgem and GEMA as the key decision makers on price controls such incentives would be diluted if Ofgem also acted as "gatekeeper" to the appeals process. Secondly an independent gatekeeper would also increase the accountability, transparency and legitimacy of the price control process it would for example remove any concerns regarding regulatory capture of Ofgem that may arise when certain appeals were rejected. Finally an independent gatekeeper would help streamline the price control process and may reduce the level of regulatory uncertainty associated with third party appeals for example by allowing network companies a clear and defined route to engage in the process as provided to telecoms companies the subject of appeal in CAT determinations. The narrow issue of whether appeals qualified on the basis of consumer interest would not require in depth knowledge of the energy industry and network company price controls commensurate with Ofgem.

For similar reasons we believe that a CC decision on an appeal should be binding not a recommendation this would incentivise both Ofgem and network companies to engage properly in the appeals process if either wanted to deviate from CC's decision they do so by specifying their rationale in a formal challenge to the CC decision. As with the independent "gatekeeper" this would enhance the accountability and legitimacy of the appeals process.

Question 2: Taking account of our ideas on the wider regulatory framework, set out in our recently published Emerging Thinking consultation paper, particularly the role of enhanced engagement by network companies and Ofgem, do you think the advantages outweigh the disadvantages, or vice versa?

It is difficult for us to judge without more detailed proposals nonetheless it is important to note that what must be demonstrated here is a clear *net* benefit to both present and future consumers. As a network company NGN envisages that there will be increased detriment in terms of higher burden on resources and greater regulatory uncertainty however we accept that does not preclude an overall net benefit to consumers.

Question 3: To what extent could the design of the right of challenge, and how it is implemented (whether through existing or primary legislation), mitigate the potential disadvantages?

As we have noted above we believe an independent gate keeper would reduce some of the disadvantages with respect to regulatory uncertainty and the risk of regulatory capture of Ofgem by any interest group or stakeholder including network companies. For similar reasons we would prefer that the CC decisions on the appeal was binding subject to formal appeal from Ofgem or network companies.

Chapter 3

Question 1: Do you have any views on whether it is preferable for us to implement a third party merits-based right of challenge through existing legislation or for Government to introduce a right through a change in legislation?

Should Ofgem wish to introduce a third party appeals mechanism it would be difficult to enshrine this process without new legislation the potential new Energy Bill may be an option after the election. Key issues such as parties that would be designated right of appeal, the appeals process and jurisdiction of the Competition Commission etc are fundamental changes to the existing regulatory framework and energy consumer rights which require parliamentary consent.

Chapter 4

Question 1: Do you have any views on the issues that need to be considered when designing a third party merits-based right of challenge?

As mentioned previously the key issue which must be proven before implementing any change is a direct net benefit to present and future consumers. This can not necessarily be delivered by assuming stakeholders such as energy suppliers can be used as proxy for such interests.

Question 2: Do you have any comments on the options that could be considered in relation to each aspect of the design of the right?

To reiterate our comments earlier the role of the "gatekeeper" we believe it should be performed by an independent body (to Ofgem) the key benefits as noted above being:

- this would maximise the incentives on both network companies and Ofgem to engage sufficiently with stakeholders and agree price control proposals that benefit all stakeholders;
- an independent gatekeeper would increase the accountability, transparency and legitimacy of the price control process it would for example remove any concerns regarding regulatory capture of Ofgem by network companies that may arise if appeals were rejected; and
- an independent gatekeeper would help provide greater clarity to the price control process and may reduce regulatory uncertainty for example by allowing network companies to engage in this process as provided to telecoms companies the subject of appeal in CAT determinations.

As we have also stated earlier the [CC's] decision on any appeal should be binding rather a recommendation to Ofgem for similar reasons above in relation to the legitimacy of the appeals process.

Chapter 5

Question 1: Do you have any comments on the potential design of a third party merits-based right of challenge?

We have nothing to add to our answers to chapter 4 above

Question 2: Do you have any alternative designs that you think Ofgem should consider?

If this is a direction that Ofgem wishes to move down it is worth considering whether an automatic referral of price control proposals to the Competition Commission as with airports, would address some of the issues raised e.g. accountability, transparency etc. One benefit of such mechanism for network companies would be that it would streamline the process and reduce regulatory uncertainty in the sense that it would be known that the price control would be reviewed again by the CC at a specified time and company management and investors could make their decisions accordingly.