

Hannah Nixon  
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Ofgem  
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6 September 2010

Dear Hannah,

**REGULATING ENERGY NETWORKS FOR THE FUTURE: RPI-X@20  
RECOMMENDATIONS**

Thank you for this opportunity to comment on the above consultation. We recognise that Ofgem have made significant progress on a number of the issues raised in the Emerging Thinking paper earlier this year and we are pleased to see that Ofgem has taken on board the views and feedback from NGN amongst others.

In general NGN is supportive of the recommendations that Ofgem has developed as a result of the RPI-X@20 review. We believe most of these proposals will positively enhance the RPI-X regulatory framework applied by Ofgem. In some cases we are uncertain as to how the mechanisms will operate and in the area of financeability we remain concerned about the potential impact of Ofgem's proposals on the cost of capital and investor perception of risk in the sector.

***Financeability***

NGN believes that unless sufficient safeguards are put in place any developments that lengthen the period over which a cash flow is remunerated introduces additional risk for a business and therefore introduces an increased risk premium into that company's cost of capital.

The RPI-X@20 recommendations contain a number of proposals that could increase regulatory cash flows (e.g. the proposal to increase capitalisation of GDN repex from 50 up to 100 percent). The result of these proposals may be that GDN cash flows are recovered over a greater number of price control periods than at present. Given the scope for regulatory policy and approach to change between price control reviews there is naturally an increased element of risk introduced as a result, this risk may not be priced into long term debt as suggested by CEPA. As such NGN supports the analysis provided by Oxera on behalf of the ENA in response to this consultation.

There are two solutions Ofgem can adopt to resolve this issue:

- Once expenditure has been approved and part of a price control the associated cash flow profile is "locked off" from further review; or
- The ex-ante cost of capital is increased to reflect the increased risk as outlined above

We recognise that given the primary objective to protect consumers interests Ofgem will be reluctant to take the first option and therefore we would expect Ofgem to increase the cost of capital accordingly if it decides to extend price control cash flows.

### ***Implementing longer term price controls and proportionate price control reviews***

We understand Ofgems rationale behind both of these proposals and can see the potential benefits for network companies. However to deliver these benefits will require careful and considered implementation otherwise the impact of these proposals could be negative.

For the longer term price control it is imperative that any mid-period review does not become a full scale review as otherwise the effect will be to shorten rather than increase review periods. Details on how this will be implemented into the existing price control framework need to set out clearly at the outset. For example we would like to be clearer on the scope for interim reviews, appeals mechanisms for interim and full reviews, provisions for re-openers, ship wreck clauses etc.

On proportionate reviews the main area of uncertainty is how “fast-tracking” of price reviews would work in practice and the incentives for well performing companies to take the fast track approach. If Ofgem expects companies to attempt the fast track option in GDPCR2 and TPCR5 then Ofgem must set out a clear framework on how these arrangements would work before the end of 2010.

### ***Future of Gas Networks***

We have been concerned throughout the RPI-x project about assumptions being made regarding the future of the gas networks. It is by no means clear that it will be efficient in either cost or environmental terms to make massive investments costing billions of pounds to facilitate the transfer of domestic heating from gas to electricity. There are scenarios under which it is possible to achieve carbon reduction targets with a significant role for the gas networks. What is known for the immediate future is that for the vast majority of domestic customers it is significantly cheaper to heat their homes with gas and that this generates less Co2. Ofgem should be open-minded regarding the future of the gas networks and recognise that there are different possible scenarios as how the future may develop.

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 'Stephen Parker', with a stylized flourish at the end.

Stephen Parker  
**Regulation & Commercial Director**