



**Association of  
Independent  
Gas Transporters**

Wood Howe, Keldwyth Drive, Troutbeck Bridge, Windermere, Cumbria, LA23 1NJ

Tel: 07790 877148 E-mail [john.barrett@aigt.org.uk](mailto:john.barrett@aigt.org.uk) Web: [www.aigt.org.uk](http://www.aigt.org.uk)

Rachel Fletcher  
Partner, Local Grids  
Ofgem  
9 Millbank  
London  
SW1P 3GE

23<sup>rd</sup> July 2010

Dear Rachel

**Reasonable Profits Test under the provisions of Standard Licence Condition 4A – Cost of Capital Review**

Thank you for your letter dated 16 June 2010.

Although we do not wish in any way to diminish the importance of the more substantive matters raised in your consultation, indeed you will see below that we regard them as being critical issues, the AIGT's response to your consultation focuses on one issue: viz that the four-week consultation is much too short to provide a meaningful response. This does have the potential to turn the consultation exercise into an empty gesture – something we are sure you are anxious to avoid. On that basis therefore our response is as follows:

1. A 4 week period contradicts Ofgem's own consultation policy of June 2002

Four weeks to consider the issues is an inadequate time-frame. The cost of capital threshold can be a complex issue to address and is in any event a business-critical issue for any company and an especially sensitive one for small companies given the well-known liquidity problems in the capital market.

If the cost of capital is set at the wrong level this could cause the IGT to fail to attract capital at efficient rates. The implications of a network operator experiencing capital raising problems may directly impact consumers. Where their finance raising position deteriorates, network operators may struggle to invest appropriately to maintain and develop their networks. As a consequence, they may not be able to meet customers' demands for connections and energy transfers. If those conditions prevail overtime then, at least in extreme circumstances, there may be a threat to security of supply.

In view of that, therefore, we would struggle to provide a meaningful response within 4 weeks - a problem which is exacerbated further by the absence of key staff and (see below) external consultants during the holiday season.

Even Ofgem's own consultation policy dated June 2002 anticipates that extra time may be allowed. Its policy indicated (at paragraph 3.10) that:

*"More time may be allowed for responses if, for example, the policy proposal is particularly complex and involved, or if the policy is at its very early stages of development, or if it falls over a holiday period when more time may need to be given". (Emphasis Added).*

You will be aware that many of the larger network companies have the benefit of price controls that are housed in special licence conditions; meaning that they can only be changed with the consent of the licensee. This inevitably makes the process of changing the cost of capital a more measured one for them and therefore one that gives comfort to lenders that due process will be followed. Whilst we readily acknowledge that IGTs are often much simpler businesses and so may not stand in need of extensive consultation periods, it does not follow that our interests can be dealt with under a shorter time frame.

Naturally, if you disagree with this view we would welcome any information you can provide which demonstrates that Ofgem has conducted other consultations relating to such an important issue as the financing of networks in so short a timeframe, especially during a holiday period.

2. A 4 week period renders the process procedurally unfair for logistical reasons

Any consultation procedure adopted by Ofgem will need to acknowledge the practical, logistic constraints on respondents. The practical problems raised by such a short time frame are:

- (i) Cost of capital calculations can by their very nature become fairly complex (see above). AIGT members would expect to be given sufficient time to interview and then to engage a consultant(s) to consider the issue and then be given sufficient time to make representations.
- (ii) Some of the Association's members will need adequate time to appraise various stakeholders in their businesses (directors, shareholders, lenders, analysts, etc) of the potential for change and obtain feedback on what policy should be pursued by the member. This process takes time and should be of interest to Ofgem itself given that you will want to know that you have captured all of the issues early on. The need to capture all of the issues relates to the need for a holistic approach-something we return to in the next section.

We suspect therefore that the relatively short timeframe allotted to this consultation could render the exercise unsafe from a procedural perspective.

3. The time period chosen is inconsistent with Ofgem's best practice duties

Such a short time runs counter to Ofgem's Regulatory Best Practice duties to be proportionate and consistent (see section 4 (5A) GA '86 as amended – "the Act") and its more general administrative duties to adopt, in effect, best administrative practice. These general duties echo those under the Act and are slightly wider in scope and, although we would be very surprised if they are needed here, can provide a remedy to an aggrieved consultee via the relevant Ombudsman route rather than via the court.

## *Regulatory Best Practice*

The Regulatory Best Practice duty is as follows:

*“(5A) In carrying out their respective functions under this Part in accordance with the preceding provisions of this section the Secretary of State and the Authority must each have regard to—*

*(a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and*

*(b) any other principles appearing to him or, as the case may be, it to represent the best regulatory practice.”*

On the issue of consistency in particular, Ofgem have previously given a longer response period to earlier reasonable profits consultations (and these earlier consultations were merely interim ones rather than a full five-yearly review) and Ofgem have already delayed consideration of metering until the IGT:IDNO review is begun in Q.4 of this year (see Ofgem announcement “*Review of Current Metering Arrangements*” 6 July 2010). The reasons given by Ofgem were that:

*“We are conscious that any review of the IGTs should be holistic and therefore take account of previous developments, and the issues raised by the planned roll-out of smart metering. (Emphasis Added)*

*Ofgem has made a commitment in its 2010/11 corporate plan to review the regulatory arrangements for IGTs and Independent Distribution Network Operators (IDNOs) and we think it is sensible to consider IGT metering as part of that review. Therefore the IGTs will not be considered as a part of the Review of Metering Arrangements.”*

We have separately queried the logic for this delay (see our letter dated 23 July 2010 to Emma Kelso) and believe that there may be good grounds for addressing IGT metering issues now so that we are not presented with a *fait accompli* later. That said, whether or not a holistic approach is appropriate for IGT metering, it is not clear why the need for a holistic approach does not apply to the reasonable profits issue. If there was ever a case for delaying an item so that it can be taken into consideration as part of the IGT:IDNO review then surely this would apply to the present consultation. Accordingly, we can see no reason why a reasonable profits consultation should be held in advance of the IGT:IDNO review; especially if this consultation is the full five yearly one.

## *Administrative Duties*

Public officials are bound to follow best practice principles which apply in addition to those best practice principles which have been given a statutory footing under the Act. These are described in the Crossman Catalogue governing fair dealing with stakeholders. The Crossman Catalogue has been fleshed out further by two important publications: the PCA's and HSC's *Principles of Good Administration* and the LGO's updated guidance to local authorities on Good Administrative Practice.

We see no obvious reason why those principles do not apply here.

Of the ten principles contained in the above, the first and fifth are relevant. The first because it highlights the importance of Ofgem following its own policies and the fifth because it underscores the point we make about needing to take a holistic approach.

First, it is a maladministrative to fail to follow a code, policy or procedure to the detriment of an individual or class of people. Plainly, this is analogous to procedural impropriety, though the origins of the procedure-statutory or by way of guidance-will be far less significant to an ombudsman and limitations placed by the courts on the concept of legitimate expectation are not generally applied.

Fifth, a decision that is made without adequate information having been gathered will often be maladministrative. This is closely analogous to the public law principles of due inquiry and taking account of relevant considerations.

### **Next Steps**

The Association shares with you the concern that the cost of capital for IGTs should continue to be appropriate across a variety of circumstances and would welcome the opportunity to meet with you to explain the stance taken in this letter and, in due course, to provide a reasoned response to the consultation issues raised. We hope that you take the comments in this letter about the procedure being adopted by Ofgem in the spirit of cooperation and helpfulness intended.

If you have any queries please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink that reads "John Barrett". The signature is written in a cursive style with a large initial 'J'.

John Barrett  
Secretary, Association of Independent Gas Transporters

Copy: Daniel Rock