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By email only

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Dear Paul

## **Response to: "Proposed Modifications to the 'Ring Fence' Conditions in Network Operator Licences.**

This response is made for and on behalf of GTC Pipelines Limited and the Electricity Network Company Limited. Whilst we recognise the need to have financial ring fence arrangements in place which "*...ensures operational continuity and promotes financial stability...*", we are concerned that the regulatory burden that these proposals place on smaller network businesses such as ourselves is not fully understood.

Our comments to Ofgem's proposals are provided below.

### **Independent Directors not required for IDNOs and IGTs**

We welcome the move to not require relatively small NWOs such as GTC Pipelines Limited and the Electricity Network Company Limited to appoint independent directors. Such a requirement would have imposed a significant, disproportionate regulatory burden and cost on us.

### **Regulatory Burden**

Ofgem's proposals state that NWO's will be allowed to recover efficiently incurred incremental costs of compliance through their price controls. This is simply not true for IGTs and IDNOs. Under the IGT form of RPC the "price" is locked at the time the network is constructed. Price changes are subject to cap and collar arrangements around the RPI. Currently, the majority of IGT prices are at the cap; i.e. there is no headroom to recover additional regulatory costs. Whilst the same cap and collar arrangements do not apply to RPC arrangements for electricity, we are concerned that the charging methodologies (CDCM coupled with method M) may not allow IDNO licensees to recover their costs in full. Although this is subject to open governance, where and how certain cost components are covered and treated is opaque. We would welcome Ofgem's views and proposals as to how they believe IGTs and IDNOs can recover additional costs imposed by additional regulatory burdens.

Ofgem comment that the costs of regulation and group board costs represent about 5% of a NWO's indirect business costs. Whilst this may be true as an average across all NWOs, we think the cost for smaller NWOs is higher, both in the respect of the proportion of indirect

costs covered by these activities, and in the proportion that indirect costs compared to total costs of the business.

## **NWO Intervention Plan**

In formulating proposals Ofgem state that they have sought to avoid a sense of 'ring fence creep'. Yet we find it difficult to view the proposal for an Intervention Plan as anything other than this.

Also, whilst Ofgem state that they would expect the Intervention Plans for smaller distributors to be 'relatively simple', we have no sense what this means in practice to assess the amount of work that work to produce and maintain such a plan. In developing these arrangements, there needs to be regulatory guidance which must be clear, unambiguous and documented. Without this, changes in personnel (both in Ofgem and in NWO's) and 'corporate memory loss' over time may lead to the spirit and intent of such requirements being lost. Such guidance will also mitigate 'scope creep' or 'ring fence creep'.

We are sceptical and remain to be convinced of the benefits that an Intervention Plan would bring compared to the costs incurred. In order to accept such a licence proposal we would welcome engagement with Ofgem on:

- What the detailed requirements for IGTs and IDNOs, such as GPL and ENC, would be.
- What mechanisms are in place to recover the inevitable additional regulatory costs the costs that we would incur.

## **Credit Rating of Licensee**

Operating as an IDNO and IGT we are required to place an amount of six months operating costs into an escrow account. These arrangements are required in lieu of us having an investment grade credit rating. In an event of financial distress such arrangements for IGTs and IDNOs provide customers with a higher level of service continuity protection than the credit rating arrangements in place for the much larger DNOs and GDNs.

This significant burden and cost on IDNOs and IGTs cannot be recovered under current RPC arrangements. Given that Ofgem are proposing enhancements of the cash lockup arrangements we question why there is a need for the escrow arrangements as well especially given that any administrator would have the same access to the future cash flows of an IGT or IDNO as we would have to the future cashflows of a GDN or DNO.

Please contact me if there are any points in our response you would want further details.

Yours sincerely

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**GTC**

