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Dear Richard

Review of Transco's Price Control from 2002 – Response to Draft Proposals

EIUG represents the largest industrial gas consumers and is therefore a key stakeholder in the current price control review. The sectors we represent account for the bulk of industrial gas consumption in the UK (excluding generation).

Our prime concern is the lack of capacity in the NTS. There is an abundance of evidence, including that from the capacity auctions, that NTS capacity is inadequate – particularly at St Fergus – and that the current situation is contributing to higher than necessary wholesale gas prices. Capacity constraints are likely to become a more frequent occurrence as demand grows and will remain a problem during summer periods unless flexibility increases.

Our members are acutely aware of the upward pressure that capacity constraints put on market prices. The cost of alleviating these constraints, even based on Transco's own estimates for St Fergus expansion (no doubt exaggerated) would still be worth paying given the likely effect on wholesale prices, which account for a far larger proportion of our costs than transmission charges.

We believe the case for NTS investment is overwhelming, and that it should be directed towards summer flexibility as well as the narrow 1:20 year peak demand criterion. Additional flexibility would facilitate greater competition between terminals, which would benefit competition in the offshore market generally. This should be funded primarily through baseline CAPEX, not long-term auctions (if introduced, their impact should be confined to fine-tuning of the investment programme). Transco should have a clear and unambiguous signal from this price review to invest, and powerful incentives to ensure that capacity targets are met.

We are sceptical about Transco's claims that they necessarily require very long lead times for NTS investment. Except where progress is partially outside Transco's control, e.g. for planning consent, we cannot understand why lead times should significantly exceed those of other utilities. In any case, why does the investment programme have to be back-end loaded, with virtually no improvement in output until the end of the review period? Transco have had years to plan this NTS expansion – why has the preliminary work (including obtaining planning consent, if required) not already been done, so that design and construction can start right away?

We support Ofgem's desire to see Transco exposed to the consequences of its balancing actions on the markets, and aligning its commercial interests more closely with those who use its system. However, we would caution Ofgem from expecting too much from these incentives – they could improve the efficiency of the gas system as a whole, and may reduce so-called 'commercial' operating constraints, but will not address the demonstrable physical capacity problems.

As for other matters, we support Ofgem's position on Transco's asset base and the general approach to the cost of capital. If anything, the return looks generous for a relatively risk-free, monopoly utility business (in the current economic conditions, many of our members would be happy to see a 6% return on capital). The operating efficiency targets also seem reasonable, especially when compared with the productivity gains made in our own industries. Like Ofgem, we do not oppose separate LDZ price controls in principle, but are yet to be convinced that the benefits would necessarily outweigh the cost and complexity of introducing such a system.

We appreciate the steps you have taken to involve customer groups in the review process and will continue to keep you informed of our concerns. We trust that Transco's output requirements will adequately reflect the needs of industrial customers and that we will see evidence of this in your final proposals document later this year.